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The battle for trade

Obama comes to Europe

The best diet for your brain



Twin twisters

Fannie Mae, Freddie Mac and the market chaos



Print Edition July 19th 2008

Twin twisters
The financial crisis claims another two victims—and once again the taxpayer picks up the pieces: leader



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Politics this week

Jul 17th 2008
From The Economist print edition

In an apparent change of policy, the United States said it would send a senior envoy to Geneva to join international discussions with **Iran** about a possible freeze and later suspension of its enrichment of uranium. The Americans had previously said they would not be prepared to negotiate formally and directly with Iran unless it first halted enrichment. See article

The **Lebanese** Shia movement, Hizbullah, handed the bodies of two **Israeli** soldiers to Israel in exchange for five Lebanese prisoners, one of whom had been serving a life sentence for killing three Israelis, including a four-year-old girl. Hizbullah refused till the day of the exchange to say whether the two soldiers, who were captured at the start of the war between Israel and Hizbullah two years ago, were alive or dead.

Lawyers acting for Israel's embattled prime minister, **Ehud Olmert**, cross-examined an American businessman who has admitted giving Mr Olmert perks and payments when he was the mayor of Jerusalem. The opposition again called for him to resign.

The former British prime minister, Tony Blair, now an international peace envoy to the Middle East, cancelled a trip to the **Gaza Strip** after the Israelis told him he risked being attacked. He would have been the most senior foreign visitor to Gaza since the Islamist group, Hamas, seized control there a year ago. A ceasefire agreed to a month ago between Hamas and Israel has been more or less holding.

The International Criminal Court indicted **Sudan's** president, Omar al-Bashir, accusing him of war crimes in Sudan's Darfur region, where up to 300,000 people are said to have been killed during the suppression of a rebellion. The Sudanese government reacted with outrage and denial. See article

Russia and China vetoed a proposal by America and Britain in the UN Security Council that would have imposed an arms embargo on **Zimbabwe** and put travel and financial curbs on President Robert Mugabe and his closest colleagues. Meanwhile, Zimbabwe's government said that inflation was running at 2.2m per cent a year; independent economists said the real figure was at least four times higher. See article

Med rep

AFP



President Nicolas Sarkozy staged a huge summit in Paris to mark the establishment of a new **Union for the Mediterranean**. Some 42 European and Mediterranean leaders attended, a diplomatic triumph for the French leader. See article

Mr Sarkozy's diplomatic skill was less in evidence when he said that Ireland would have to hold a second vote on the European Union's **Lisbon treaty**, just days before going to Dublin to "listen" to the voters who rejected it.

Belgium's political crisis re-erupted when the prime minister tendered his resignation after failing to push through devolution reforms. Yves Leterme had formed a government only in March, nine months after an election. See article

Turkish troops said they had killed 22 guerrillas of the Kurdistan Workers' Party (PKK) in clashes in south-eastern Turkey. The news came a day after a Turkish prosecutor charged 86 people for their alleged involvement in a coup plot against Turkey's government. See article

Russia reduced its oil supplies to the **Czech Republic** by half for "technical reasons". The cut came just after the Czechs agreed to host an American missile-defence radar. Strangely, the technical reasons did not affect oil supplies to any of the Czechs' neighbours.

A failed harvest of votes

Argentina's Senate narrowly rejected a presidential proposal to raise taxes on agricultural exports, a blow to the beleaguered president, Cristina Fernández de Kirchner. The lower house had approved the measure, which is vehemently opposed by farmers.

A former American soldier, Robin Long, was deported from **Canada**, long a haven for American deserters, after his application for refugee status was turned down. He fled there in 2005 as his unit was about to be sent to Iraq, claiming he would suffer irreparable harm if forced to participate in an "illegal war of aggression". He is believed to be the first American army deserter ever to be deported from Canada.

AP

In their first meeting since their relations turned sour last autumn, the presidents of **Colombia** and **Venezuela** agreed to make up. No one is taking any bets on how long their reconciliation will last. See article

Trying to dig out of a hole

George Bush lifted a presidential moratorium on **offshore oil drilling**, arguing that opening up exploration would help ease high oil prices. The decision was mostly symbolic as Congress has its own ban.

John McCain and Barack Obama focused on **foreign policy**. Both presidential candidates pledged more troops and aid to win the war in Afghanistan, but they clashed over Iraq. Mr McCain criticised Mr Obama for laying out proposals before he had even embarked on his much touted fact-finding mission. See article

The new front-line

AP



Nine American soldiers were killed in **Afghanistan** when insurgents attacked a small, recently built outpost near the Pakistan border. It was the most deadly single battle for Americans there since 2005. See article

Anwar Ibrahim, leader of the opposition in **Malaysia**, was arrested over allegations of sodomy made by a former aide. Mr Anwar says the charges are politically motivated. His conviction for sodomy in 1998 was later overturned. See article

The presidents of **Indonesia** and **Timor-Leste** received the report of their two countries' joint commission investigating the violence surrounding Indonesia's withdrawal from its former province of East Timor in 1999. The report laid much of the blame on the Indonesian army, but neither country plans to prosecute any of the individuals responsible.

On the 21st anniversary of the lifting of martial law in **Taiwan**, the president, Ma Ying-jeou, offered an apology for his Kuomintang party's killing and imprisonment of dissidents in the 1950s and 1960s.

Following North Korea's partial declaration of its nuclear programme, Lee Myung-bak, **South Korea's** president, called for dialogue with the North to resume, and offered to renew humanitarian aid without conditions. Mr Lee's call came just after a South Korean tourist strolling in a prohibited area was shot dead by a North Korean soldier. See article

Business this week

Jul 17th 2008
From The Economist print edition

It was another tumultuous week for America's banking industry. The Treasury led an emergency rescue plan for **Fannie Mae** and **Freddie Mac** after their share prices were pummelled when markets lost confidence in their ability to raise capital amid potentially huge losses. The government-backed companies own or guarantee about half of America's outstanding mortgages, worth some $5.2 trillion. See article

Investors were also rattled by the collapse of **IndyMac** in California, caused by a run on the bank that began after Senator Chuck Schumer questioned its health. The federal agency that insures deposits took over and the bank reopened under the management of the feds. Despite assurances, hundreds of angry customers queued to withdraw their savings.

Talk is not cheap

The Securities and Exchange Commission introduced an emergency measure (to last for a week at minimum) that clamps down on **short selling** in the shares of 19 financial companies, including **Lehman Brothers**. Its share price fell sharply amid continuing rumours that it faces bankruptcy. Some blame the rumours on hedge funds trying to drive the stock down. See article

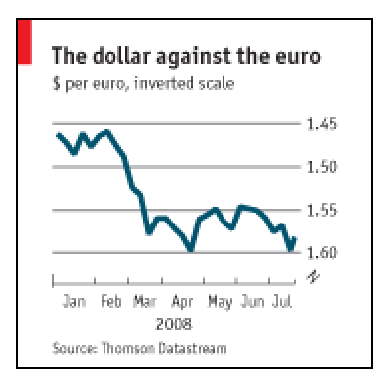
Other investment banks raised some much-needed cash ahead of what is expected to be another set of dismal quarterly earnings. **Citigroup** agreed to sell its German retail banking business to France's **Credit Mutuel** for $7.7 billion. And **Merrill Lynch** looked set to sell its 20% stake in **Bloomberg** for $4.5 billion.

A damning report by Britain's parliamentary ombudsman slammed regulators for failing to foresee the near collapse of **Equitable Life** in 2000. The company had to cut the pensions and retirement savings of more than 1m policyholders to stay afloat. The ombudsman said the government should pay compensation and apologise to Equitable's clients.

Alliance & Leicester, a mid-sized British bank, agreed to a takeover offer from Spain's **Santander** worth £1.3 billion ($2.5 billion), or about half the price that was touted during negotiations six months ago.

Consumer-price indices in America and Britain surged by their highest levels since the early 1990s. Gordon Brown postponed the increase to an (unpopular) levy on fuel, because (he said) of rising energy prices. See article

Bad news in the financial markets led to further pressure on the **dollar**, which fell to record lows against the euro.



The slump in Spain's housing market resulted in one of the country's biggest corporate collapses, when **Martinsa Fadesa**, a property developer, sought administration.

Self reliance

General Motors announced steps to boost its cash position. Faced with a dismal domestic market, the carmaker said it would raise $15 billion by selling assets, suspending its dividend and reducing its staffing costs. The actions underlined the difficulties the carmaker has in tapping money markets to raise funds.

In Europe's biggest takeover battle this year, **Schaeffler**, a privately held industrials group, made an *euro*11.2 billion ($17.8 billion) offer for **Continental**, one of the world's biggest suppliers of car parts and

a leader in new fuel-efficiency technology. See article

South Korea reaffirmed its notorious leniency towards white-collar crime when the former chairman of **Samsung Group**, Lee Kun-hee, was convicted of evading taxes but received a suspended three-year prison sentence. He was fined 110 billion won ($109m). The court also dismissed the more serious charge that Mr Lee sold shares at artificially low prices in order to pass corporate control to his son.

To their good health

After a month-long pursuit that had turned increasingly hostile, **InBev** won over **Anheuser-Busch** with a sweetened takeover offer worth around $52 billion. Based in Belgium, InBev's is one of the biggest ever foreign acquisitions of an American company. The new entity will be the world's biggest brewer.

There was more consolidation in the mining industry as **Cleveland-Cliffs**, America's biggest iron-ore producer, agreed to buy **Alpha Natural Resources**, which mines coal, in a $10 billion deal.

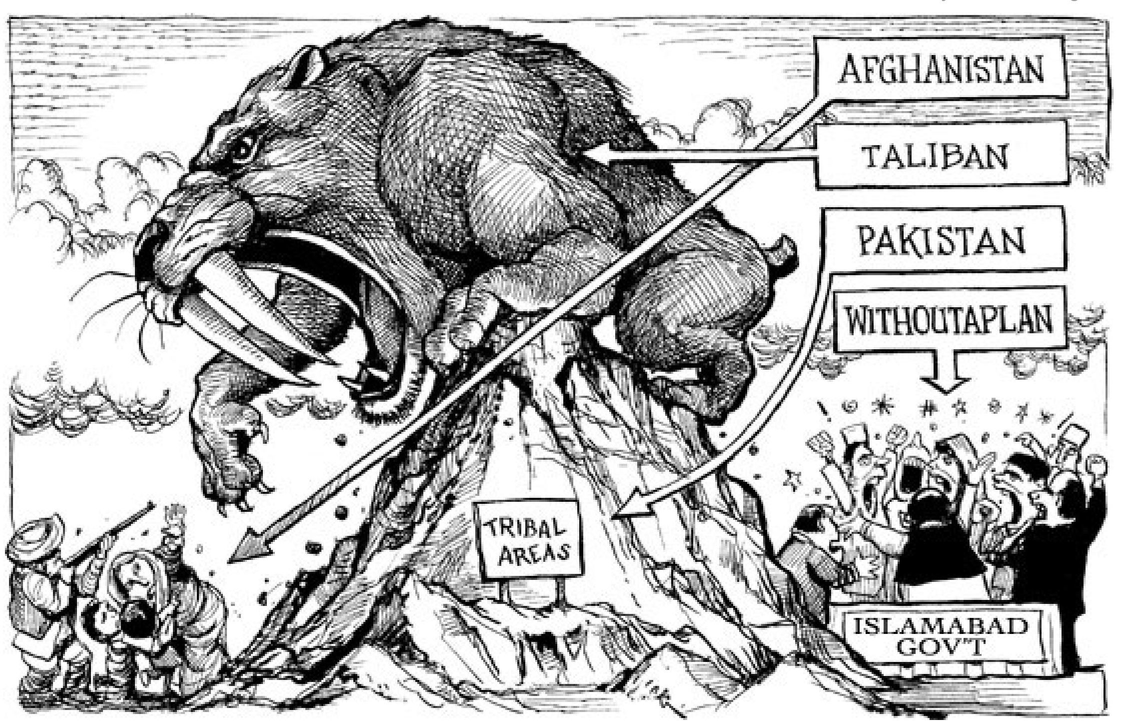
A federal judge handed **eBay** an important legal victory by ruling that it was not liable for the sale of fake jewellery on its website. The lawsuit was brought by Tiffany, the world's second-biggest luxury jeweller. The decision is a relief for eBay; in similar cases in Europe recently courts have sided with luxury-goods companies.

A report from a congressional subcommittee estimated that the United States Treasury loses $100 billion a year in **offshore tax abuses**.

KAL's cartoon

Jul 17th 2008
From The Economist print edition

Illustration by Kevin Kallaugher



Banks and markets

Twin twisters

Jul 17th 2008
From The Economist print edition

The financial crisis claims another two victims—and once again the taxpayer picks up the pieces



IT WAS another of those frantic weeks that were never meant to happen in the world's most advanced economy. On July 13th Hank Paulson, America's treasury secretary, stood on his department's steps like some emerging-market finance minister, and unveiled an emergency plan to save Fannie Mae and Freddie Mac, two mortgage giants that owe or guarantee $5.2 trillion. Two days later, Ben Bernanke, chairman of the Federal Reserve, put the fear of God into the markets, warning Congress of a foul amalgam of inflation and economic distress.

The immediate lesson is that the financial crisis, nearly a year old, is far from over (see our coverage, beginning with this article). Gloomy investors are gunning for banks of all types. In America the prices of houses and shares are falling, and the cost of food and energy has soared. Consumers are almost certain to cut back. The euro-area economy may have shrunk in the latest quarter. Central banks around the world are having to raise interest rates to curb inflation, and the dollar looks vulnerable. Even if the downturn proves less sharp than pessimists fear, it is likely to last longer than optimists hope.

Freddie and Fannie have changed that equation only slightly. Their importance lies in what their rescue says about the financial system. At Fannie and Freddie—and, shockingly, at the investment banks—the profits were privatised, but the risks were socialised. One Republican senator complained that he thought he had "woken up in France". Mr Paulson was still right to intervene: the collapse of Fannie and Freddie would have been a catastrophe. But by not formally nationalising them, he has let down taxpayers and made the same deeply uncapitalist mistake the British government initially made with Northern Rock, a failed mortgage bank it tried to prop up.

Mark to market, or market to Marx?

The debt is what matters with Fannie and Freddie, but the shares were the trigger. When investors realised they would eventually need more money to cover their looming losses, there was a run on the stock. This rapidly became a test of a tacit government pledge to back their debt. Had the government hinted that it wanted to wriggle free from its vague promises, the debt would have crashed; the banking system would have been crippled by new losses; foreign investors would have fled a country that broke its word; and the housing market, a trifle short of lenders just now, would have lost its main backers. Mr Paulson vowed to lend Fannie and Freddie money and buy their shares if necessary. They could also

borrow from the Fed. The next day investors queued up to buy Freddie's bonds.

That is plainly not the end of it for the taxpayer. It seems quaint that critics once complained that finance was all about untrammelled markets and deregulation. On July 11th regulators took over IndyMac Bancorp, a Californian thrift, after the second-biggest bank failure in American history. After the rescue of Bear Stearns in March, the Fed agreed to back investment banks with its balance sheet. Congress is chewing over a small subsidy to troubled mortgage owners. If another large bank became vulnerable, more rescues would beckon.

Capitalism rests on a clear principle: those who get the profits should take the pain. For the system to work, bankers sometimes need to lose their jobs and investors their shirts. Yet were a collapsing Bear Stearns or Fannie Mae to sow destruction for the sake of a principle, it would impose a terrible price in lost jobs and output on everyone else. The unpalatable truth is that by the time a financial crisis hits, the state often has to compromise—to impose as much pain as it can, of course, but to shoulder a large part of the losses nonetheless.

That formula comes at a heavy price. Fannie and Freddie were supposed to help Americans buy their own homes, by making the mortgage market work better. But it has been an awful deal for the taxpayer—a Fed economist calculated the implicit debt-guarantee was worth a one-off sum of between $122 billion and $182 billion. Because Fannie and Freddie barely lowered the cost of borrowing, little of this subsidy went towards boosting home ownership. Instead, just over half—about $79 billion—went straight to their shareholders.

Normal financial-services firms should have been dealing in the safe, middle-of-the road mortgages that Fannie and Freddie specialise in. Except that they were crowded out into subprime mortgages. Fannie and Freddie should never have grown so large. Except that they wanted to exploit the margin between the government-guaranteed borrowing costs and the commercial lending income. They should have been stopped by Congress and their regulator. Except that they spent some of their subsidy on a fierce lobbying machine.

Fannie must not

In the past, we have argued for privatising Fannie and Freddie completely. But now that the guarantee is explicit, Mr Paulson should seek to secure the gains for taxpayers and treat Fannie and Freddie like one of their own mortgages, by nationalising them, breaking them up and selling them on. That would almost double the public debt—but only in book-keeping terms. The liability is already implicit (as at Northern Rock), and, unlike Treasuries, it is ultimately backed by housing as collateral.

It is harder to know what to do about all those other implicit state guarantees—seemingly to any financial outfit. The first instinct should be to make sure someone suffers; shareholders and managers at the very least. It was a valuable lesson when some of IndyMac's depositors could not get hold of their money because they exceeded the government guarantee.

If you cannot let firms fail in a bust, then you must contain them in the boom. That helps explain why the investment banks now need more supervision; why financial firms should have to hold more capital as a boom gathers pace; and why monetary policy should lean against rising asset prices. Regulation is necessary, but beware the state being seduced into taking on duties it cannot possibly carry out well. As Fannie and Freddie show, regulators are easily captured and outwitted. The best controls are transparency and competition. When possible the government needs to stand back. Sadly, it failed to do so in the American mortgage market.

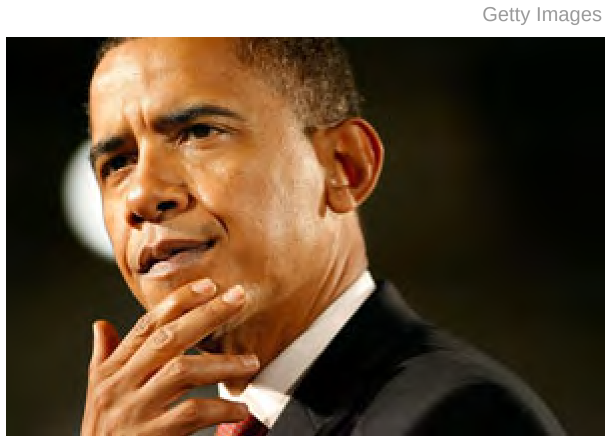
Barack Obama on tour

Welcome, Mr would-be President

Jul 17th 2008
From The Economist print edition

But foreigners would be wise to temper their Obamamania, if only to limit future disappointment

Getty Images



IF THE business of electing the most powerful man in the world were up to the world, rather than just those pesky Americans, Barack Obama would face no contest. A poll for the *Guardian* this week, on the eve of Mr Obama's whirlwind tour of Europe and the Middle East (half a dozen countries in a week, some for the first time in his life), shows that Britons would back him against John McCain by the astonishing margin of five to one. The Pew Research Centre reported last month that, in each of the main European countries, at least twice as many people have confidence in Mr Obama as in his rival. Elsewhere things are a bit more nuanced, but from Mexico to China, and from Russia to Australia, the foreigners are firmly in the Obama camp.

There are reasons for them to be more cautious. Marvellous orator and skilled electoral tactician though he may be, Mr Obama has not repealed the basic laws of politics. Most obviously, he may not win. Rasmussen, a pollster, rattled the Obama machine this week by showing the two candidates tied, and most other analysts agree that the bounce he enjoyed after seeing off Hillary Clinton has been small and short-lived. Mr Obama still definitely has the edge, but opinion at home diverges sharply from that in most of the rest of the world.

Second, President Obama would not be answerable to the world that so adores him. A president is elected by America's more ambivalent people, and is accountable only to them. And his powers are mightily constrained by Congress, which is even more immediately accountable to its electorate.

Finally, there are some disquieting signs of a tendency on Mr Obama's part to tailor his message to whichever audience he is talking to. All politicians do this of course. But Mr Obama's two-steps have become Astaire-like. For instance, in his primary battle with Mrs Clinton, Mr Obama laid out a timetable for a virtually complete withdrawal from Iraq within 16 months of taking office, specifying a rate of one to two brigades a month. Since starting to campaign in the general election, he has fudged this clear line: he committed to withdrawal again this week (see article), but he has also been careful to give himself wriggle-room on its pace. Similarly, he once talked of negotiating with the Iranian leadership without preconditions: now he talks of the need for "preparations".

Both these alterations make sense, but many Europeans won't like them. Other bits of pandering could be more costly. Mr Obama recently told the main pro-Israel group in Washington that Jerusalem must never be divided, a position that goes beyond those of the Clinton and Bush administrations (not to mention that of many Israelis). Then he backtracked.

Doffing the cap

On trade, Mr Obama used to demand the renegotiation of NAFTA; now he stresses his dedication to the cause of free trade. A welcome adjustment, but he is almost certain, if elected, to have a heavily Democratic Congress which is liable to send him protectionist legislation he may find it hard to veto. On climate change he, like Mr McCain, favours a cap-and-trade system. But the Democrat-controlled Congress recently failed to agree even on a watered-down version of such a plan, without any need for a veto from George Bush.

On all these fronts, in fact, there are doubts: doubts as to just what Mr Obama's positions as president would actually be, and doubts over what he could get through Congress. Those doubts will not stop the crowds turning out for him, even if he fails to commandeer the Brandenburg Gate as his backdrop. But the fans should bear in mind that what they see is not precisely what they will get.

Al-Qaeda's global jihad

How to win the war within Islam

Jul 17th 2008
From The Economist print edition

In the long run, al-Qaeda will be defeated by Muslims, not foreigners. But the West can still help



AMERICA'S "global war on terrorism", now in its seventh year, has gone on longer than the second world war. Will it ever end? Optimists believe some kind of victory is in sight: Iraq is improving; al-Qaeda has been unable to stage a big attack in the West in three years; and terrorists have shown little sign of using weapons of mass destruction. Jihadists face an ideological backlash, even from radical "brothers" who support *jihad* but disagree with killing Muslims.

Welcome as al-Qaeda's setbacks may be, the world should not be complacent. As our special report in this issue explains, the threat is likely to last for decades. One reason is that al-Qaeda, though weaker in Iraq, has created a new sanctuary in Pakistan's tribal belt. Another is that al-Qaeda's ideology has spread far and wide thanks to the internet and ease of travel. A third is that anti-Americanism remains powerful across the Muslim world. Only a tiny proportion of the world's billion or so Muslims need to take up *jihad* to create serious trouble.

That is particularly true because al-Qaeda is so nebulous and its violence, unlike that of earlier nationalist or sectarian terrorists, is so unrestrained. The days when the Irish Republican Army telephoned warnings of its bombs, and at times apologised for killing bystanders, seem quaint in an age of human-guided bombs seeking to maximise bloodshed.

In the 19th century anarchists mainly assassinated rulers; in the 1970s terrorists typically killed tens of people; and by the 1980s and 1990s hundreds died in bombings. On September 11th 2001 al-Qaeda killed nearly 3,000 people. If it had chemical, biological or radiological weapons or, less likely, nuclear ones—all big "ifs", admittedly—it would use them.

For global jihadists the reward is in paradise, so life is cheap. They do not seek realistic political gains, but dream of restoring the mythologised caliphate that was abolished by Ataturk in 1924. Al-Qaeda has woven many strands of grievance into a simple single narrative: Islam is under attack from all sides; America, the West, the Jews (along with puppet Arab leaders and treacherous Shias) are to blame; it is the duty of every Muslim to fight them; and Muslims who object are apostates. Thus is mass murder justified as a defence of Islam.

How to confront the menace? Al-Qaeda must be denied victory, denied sanctuary and denied the ability to organise attacks. Regardless of the rights and wrongs of Western intervention, America must not leave Iraq over-hastily and will need to shore up its forces in Afghanistan. In time, though, the West should draw back from combat in favour of more discreet assistance. Al-Qaeda seeks to attack the "far enemy",

America, because the “near enemy”, the region’s governments, are hard to fight. The West should seek to invert this equation. It must encourage and help weak governments, such as Pakistan’s, to extend their writ and deny the terrorists a haven. International intelligence co-operation must be strengthened.

All this will mean supping with less-than-savoury figures. But the West must not lose sight of its most compelling idea: democracy. The greater struggle against jihadists is in the realm of ideas. Al-Qaeda must be denied the claim to be defending Muslims or to speak on their behalf. Jihadists say democracy is sinful “man-made” law, but Muslims everywhere seize the right to choose their leaders when given the opportunity.

Democracy, though, is neither an instant nor complete solution. Elections can heighten sectarian tensions, and may produce weaker or more anti-Western governments. It becomes discredited if it is seen as an imposition, or if democracies use torture. Nevertheless, it offers the best hope of moderating those who use Islam as a weapon of protest. Authoritarian regimes, even if friendly, should be nudged towards reform.

In Pakistan America invested all in its military ruler, Pervez Musharraf, but his support collapsed. Islamists who are not violent, like the Muslim Brotherhood in Egypt, should be able to contest free elections. In Turkey, secularists are wrong to try to ban the Islamist-tinged ruling party, AKP (see article). Preventing moderate Islamists from gaining power at the ballot box only encourages extreme ones to seek it by violence.

Some lump together all forms of Islamism as a deadly enemy, akin to fascism and communism. A more accurate analysis, and a better strategy, would be to disaggregate the problems. The rhetoric of the “global war” on terrorism only strengthens global *jihad*. As the West learns the limits of force, it is Muslims, not foreign soldiers, who will defeat al-Qaeda.

Yet foreigners do still have a role to play in what is, at its core, a violent contest within Islam. A useful move would be to make a greater effort to extinguish some of the fires of radicalism, such as the conflicts over Palestine and Kashmir. But diplomacy, like democracy, is no panacea. Muslim resentment of the West has a complex pathology, dating back to the Spanish *reconquista* in medieval times; that is hardly something that can be undone. Still, it is worth addressing real grievances.

Six excellent ideas

In an internet video in September 2007 Abu Yahya al-Libi, a prominent al-Qaeda leader, mockingly gave the West six tips to wage ideological warfare: highlight the views of jihadists who renounce violence; publicise stories about jihadist atrocities against Muslims; enlist Muslim religious leaders to denounce jihadists as heretics; back Islamic movements that emphasise politics over *jihad*; discredit and neutralise jihadist ideologues; and play up personal or doctrinal disputes among jihadists. These would indeed be good starting-points.

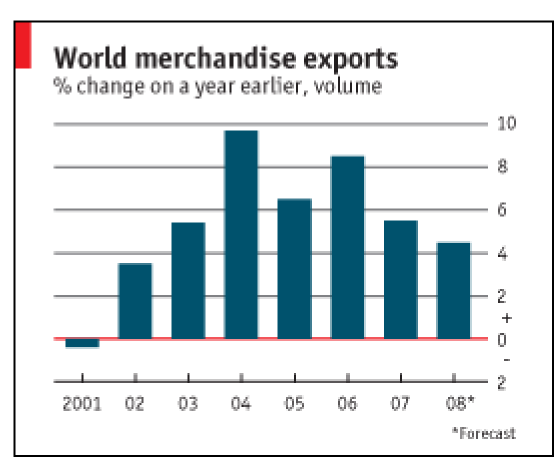


Trade

Remember Doha?

Jul 17th 2008
From The Economist print edition

An opportunity to cheer up the world economy



THERE have been harder trade rounds. Seventy-five years ago, the world's leaders collected in the Hall of Fossils in London's Geological Museum with the aim of ending a tariff war. The talks finished in ignominious failure. So distempered did things become that one drunk American delegate threatened another with a knife in the hallway of Claridge's hotel.

On July 21st trade ministers will gather at the World Trade Organisation's (WTO) headquarters beside Lake Geneva, hoping to make a breakthrough in the interminable Doha round of trade talks (see article). By the end of their meeting, some may turn to drink; one or two may be tempted to knife the round. But their aim is to agree on a template for liberalising trade in farm products and industrial goods, and to "signal" some compromises on services. The stakes are not as high as they were in 1933, of course. But they are higher than at any time since the Doha round began, in the wake of an economic slowdown and a terrorist catastrophe, in November 2001.

The WTO's director-general, Pascal Lamy, puts the odds of success at more than 50%. That, sadly, seems optimistic. America's trade representative does not have the "trade promotion authority" that would allow her to conclude a deal without fear of congressional amendment; India's commerce minister must race back to Delhi during the meeting to vote in a "trust" motion faced by his minority government; and the EU's chief negotiator lacks even the pretence of support from France's president. The hope is that these hamstrung negotiators can set down, in black and white, whatever progress they have made thus far, so that the next American president, Indian government and EU commission will not undo it all.

That "progress" is feeble. The Doha round will not liberate 100m souls from poverty nor add hundreds of billions to global income, as some economists once dared to hope. In most cases, the deal on offer does little more than lock-in the status quo. Since the last round, some big emerging markets have cut their tariffs unilaterally, without waiting for WTO negotiations. This has left a big gap between the tariffs countries now charge and the maximum they are allowed to impose. Trade negotiators haggle over the latter, but exporters care more about the duties they actually pay.

High food prices have also left the round looking anachronistic, if not obsolete. The Doha draft would stop members subsidising their farm exports, but says nothing about the opposite, more pressing problem of governments banning food exports. And thanks to high prices, America's farm handouts have dropped far below the spending limits contained in the draft Doha deal. One negotiator wonders if the proposals now pass the "laugh test".

Most favoured institution

This seems a meagre return for over six years of negotiations. But there are two compelling reasons to support the deal. First, the status quo is worth passionately defending if the alternative is a lot worse. Unfortunately, that is now a distinct possibility. The growth of trade is slowing and protectionist sentiment rising. In America, according to the Pew Research Centre, support for trade has fallen by 25 percentage points since the round was started. It is now lower in the United States than in France. Mr Lamy describes his organisation as the world's insurance policy against protectionism. Now is precisely the wrong time to let that cover lapse.

The second reason to support Doha is to bolster the WTO itself. Many argue that trade rounds are now impossibly cumbersome: the WTO's membership is too large, the scope of talks too wide. But the last trade round, completed in 1994, went on longer and ranged even wider. Indeed, the Doha round has flagged partly because its remit is so narrow. America and Europe are pressing the emerging markets so hard on industrial tariffs because much else that interests them has been left off the agenda.

The breadth of the WTO's membership is one of its glories. Of all the economic institutions that trace their roots to the Roosevelt era, the WTO has accommodated new powers most readily. India and Brazil have enjoyed a voice in this round more than commensurate with their weight in world trade. The organisation upholds the unfashionable principle that countries should not discriminate among their trading partners: they should offer to everyone the best deal they offer to anyone. That allows the weakest members to piggyback on the negotiating clout of the strongest.

If ministers fail, the sky will not fall, as it did in 1933. At least not yet. But historians could still see failure next week as the moment when the WTO started to lose its animating force. Ministers must not let the WTO's lakeside villa become another Hall of Fossils.

The International Criminal Court

Justice or expediency in Sudan?

Jul 17th 2008
From The Economist print edition

In an imperfect world, there is still a need to weigh the demands of both

Reuters



ALL that is needed for evil to prosper is that good men do nothing. Edmund Burke's familiar motto is a useful place to start when judging this week's decision by the prosecutor of the International Criminal Court (ICC) to request an arrest warrant for the president of Sudan, Omar al-Bashir, so that he can be put on trial for genocide, crimes against humanity and war crimes in Darfur. A dreadful evil has indeed been perpetrated in Sudan's western province these past five years: mass killing, mass rape and the deliberate uprooting of millions of people. No decent person can fail to hope for an end to the suffering and for those responsible to be brought to justice.

The prosecutor's decision, however, also lays bare a familiar truth. In many cases, these two desires—for an end to suffering and for justice to be done—come into conflict, necessitating a hard choice. Worse, the choice must sometimes be made in a fog of uncertainty. In Darfur, for example, nobody can be sure of what will happen if the ICC's judges now agree to indict Mr Bashir and if the UN Security Council decides not to exercise its right to stay the court's hand (see article).

Will he take revenge, by co-operating even less with aid and peace efforts and ramping up the violence? Will he just huff and puff and do nothing? The only certainty is that justice, if it is done at all, will not be done quickly. Popular in Khartoum, supported by China and the Arab world, Mr Bashir is not meekly going to stand down and report to The Hague for trial. He will work harder to stay put. The precedent of Slobodan Milosevic, carted off to the dock after falling from power in Serbia, has not been lost on the world's bad men. Some people say such indictments prolonged the tyranny of Charles Taylor in Liberia and are now obstructing chances of peace with the murderous Lord's Resistance Army in Uganda.

The spectacle of justice thwarted is hard to stomach. But in the argument between justice and expediency, both must have their say. It would be wonderful if the perpetrators of the slaughter in Darfur were brought to justice. The heart demands it, and to some degree the head demands it too. Ever since the trials in Nuremberg after the second world war, the hope has been that if heads of government and their lieutenants learn that even they are not above the law, fear of punishment will one day deter the powerful from committing great crimes. That, it is not too pompous to say, would in the long run be a marvellous advance in the human condition.

In the immediate press of events, however, the moral calculation often pushes the other way. Only this week Indonesia and Timor-Leste published a report blaming the Indonesian army for the atrocities committed in the former East Timor. But, to keep the peace, there is no hint of bringing anyone to trial. None of the big shots who oversaw apartheid ever faced serious punishment. Till recently, dictators who ordered thousands of "disappearances" in Latin America's dirty wars were allowed to slip into easeful retirement. Terrorists in Northern Ireland and Palestine have been forgiven their crimes in return for desisting. Such decisions are never easy: just ask the victims. But the hunger for peace will occasionally

trump the appetite for justice if forgiveness and amnesty are the only way to end wars or move societies from dictatorship to democracy.

Give justice her sword

Where does that leave the high hopes that accompanied the creation of the ICC ten years ago? Still strong, we believe. Examples of justice denied do not mean that this noble enterprise is doomed to fail. On the contrary, the trials in various courts of Milosevic, Mr Taylor and perhaps eventually Mr Bashir too might indeed deter the war criminals of the future. But international law is not like domestic law. At their best, national laws enjoy the legitimacy conferred on them by accountable legislatures. National courts operate inside established systems of law-enforcement. The international system of law and order, by contrast, remains highly imperfect.

The case of Darfur is especially hard. A UN Security Council so divided that it could not even pass mild sanctions on Robert Mugabe in Zimbabwe has spent five years dithering over the genocide in Sudan. The ICC must now issue its indictment against Mr Bashir if the evidence warrants it. That is its job. But the main work of ending the suffering in Darfur belongs to the Security Council and its members. They should use their power to suspend the court's indictment as an extra form of leverage on Mr Bashir—but, crucially, they must add the threat to use force if Sudan refuses to make a deal. A court on its own cannot bring either peace or justice.

Piracy

Look for the silver lining

Jul 17th 2008
From The Economist print edition

Piracy is a bad thing. But sometimes companies can turn it to their advantage

Illustration by Claudio Munoz



“MERCHANT and pirate were for a long period one and the same person,” wrote Friedrich Nietzsche. “Even today mercantile morality is really nothing but a refinement of piratical morality.” Companies, of course, would strongly disagree with this suggestion. Piracy is generally bad for business. It can undermine sales of legitimate products, deprive a company of its valuable intellectual property and tarnish its brand. Commercial piracy may not be as horrific as the seaborne version off the Horn of Africa (see article). But stealing other people’s R&D, artistic endeavour or even journalism is still theft.

That principle is worth defending. Yet companies have to deal with the real world—and, despite the best efforts of recorded-music companies, luxury-goods firms and software-industry associations, piracy has proved very hard to stop. Given that a certain amount of stealing is going to happen anyway, some companies are turning it to their advantage.

For example, around 20 times as many music tracks are exchanged over the internet on “peer to peer” file-sharing networks as are legitimately sold online or in shops. Statistics about the traffic on file-sharing networks can be useful. They can reveal, for example, the countries where a new singer is most popular, even before his album has been released there. Having initially been reluctant to be seen exploiting this information, record companies are now making use of it (see article). This month BigChampagne, the main music-data analyser, is extending its monitoring service to pirated video, too. Knowing which TV programmes are being most widely passed around online can help broadcasters when negotiating with advertisers or planning schedules.

In other industries, piracy can help to open up new markets. Take software, for instance. Microsoft’s Windows operating system is used on 90% of PCs in China, but most copies are pirated. Officially, the software giant has taken a firm line against piracy. But unofficially, it admits that tolerating piracy of its products has given it huge market share and will boost revenues in the long term, because users stick with Microsoft’s products when they go legit. Clamping down too hard on pirates may also encourage people to switch to free, open-source alternatives. “It’s easier for our software to compete with Linux when there’s piracy than when there’s not,” Microsoft’s chairman, Bill Gates, told *Fortune* magazine last year.

Another example, from agriculture, shows how piracy can literally seed a new market. Farmers in Brazil wanted to use genetically modified (GM) soyabean seeds that had been engineered by Monsanto to be herbicide-tolerant. The government, under pressure from green groups opposed to GM technology, held back. Unable to obtain the GM seeds legitimately, the farmers turned to pirated versions, many of them “Maradona” seeds brought in from Argentina. Eventually the pirated seeds accounted for over a third of

Brazil's soyabean plantings, and in 2005 the government relented and granted approval for the use of GM seeds. Monsanto could then start selling its seeds legitimately in Brazil.

Innovators ahoy

Piracy can also be a source of innovation, if someone takes a product and then modifies it in a popular way. In music unofficial remixes can boost sales of the original work. And in a recent book, "The Pirate's Dilemma", Matt Mason gives the example of Nigo, a Japanese designer who took Air Force 1 trainers made by Nike, removed the famous "swoosh" logo, applied his own designs and then sold the resulting shoes in limited editions at $300 a pair under his own label, A Bathing Ape. Instead of suing Nigo, Nike realised that he had spotted a gap in the market. It took a stake in his firm and also launched its own premium "remixes" of its trainers. Mr Mason argues that "the best way to profit from pirates is to copy them."

That this silver lining exists should not obscure the cloud. Most of the time, companies will decide to combat piracy of their products by sending in the lawyers with all guns blazing. And most of the time that is the right thing to do. But before they rush into action companies should check to see if there is a way for them to turn piracy to their advantage.

On the Lisbon treaty, pesticides, Colombia, Israel, guns, oil, politicians

Jul 17th 2008
From The Economist print edition

The status of Lisbon

SIR – You said that the lower chamber of the Czech Republic's Parliament approved the Lisbon treaty and that senators are now asking the constitutional court to vet it ("The ratification game", June 28th). This statement is not correct and as prime minister I would like to set the record straight.

The ratification of the treaty is being carried out simultaneously in both chambers of Parliament. In April the Senate submitted the treaty to the constitutional court for review and the various committees of the Chamber of Deputies suspended further proceedings on the document pending the result of that review. The treaty's ratification process has therefore been suspended in both chambers.

I would also like to point out that it is wrong to think that this means the Czech Republic is needlessly holding up the treaty's ratification. A review of the treaty's constitutionality may actually contribute to its acceptance among the political elite and Czech citizens, and I consider this approach to be entirely legitimate and responsible.

Mirek Topolanek
Prime minister of the Czech Republic
Prague

What's in your food?

SIR – Your article on the regulation of pesticides should have pointed out that slightly exceeding the "maximum residue levels" in some food, as occasionally happens, is a risk perhaps equivalent to the likelihood of being hit on the head by a meteorite ("A balance of risk", July 5th). Of greater risk to humans is the exposure to thousands of pesticides made naturally by plants (to kill herbivorous insects) and found in all fruits and vegetables. The average daily diet contains a quarter teaspoon of natural nerve toxins, endocrine disrupters, carcinogens and chemicals that damage chromosomes, skin, blood and the thyroid.

Humans are not adapted to these natural chemicals, in which the margin of safety is about tenfold compared with traces in synthetic pesticides (some 10,000-fold higher). Yet unqualified environmental groups and European bureaucrats are obsessed with agricultural pesticide safety, basing their assumptions on unjustified fear and anxiety. Neither makes for good policy.

Anthony Trewavas
Professor of plant biochemistry
Institute of Molecular Plant Sciences
Edinburgh

SIR – The proposed change to European regulations on pesticides could have serious consequences for farming. The European Commission has not conducted a proper impact assessment of the legislation in question, but the British government and independent experts predict that it could have a devastating effect on European food production.

Politicians should demand evidence-based proposals and independent analysis to enable them to make informed decisions. At this critical time, with grain prices soaring, we should not be playing politics with our food. Farmers need the tools to grow high quality food at a price we can afford.

Anne Buckenham

Director of policy
Crop Protection Association
Peterborough, Cambridgeshire

Unfriendly neighbours

SIR – I could not disagree more with your opinion that Álvaro Uribe should not seek a third term as Colombia's president ("Gracias and good night", July 5th). Relinquishing power after two terms may be an ideal, but these are not normal times. Venezuela is determined to destabilise Colombia, with Hugo Chávez trying to introduce his brand of 21st-century socialism there. It is only because of Mr Uribe's policies, intelligence and huge level of support among the public that Colombia has not followed the path of Ecuador, Bolivia and the like.

Jorge Bernal
New Orleans

Prisoner dilemma

SIR – Once again Israel is paying an exorbitant price for its abducted soldiers in a prisoner swap with Hizbullah ("A dubious trade", July 5th). It is unfortunate that the international community did not stand behind a United Nations Security Council resolution that called for the unconditional release of the soldiers, but this is not the first time. The conditions for prisoner swaps were set two decades ago, to the detriment of Israel. In the 1985 Jibril deal Israel released 1,150 prisoners in return for three Israeli soldiers. And in 2004 it freed hundreds of Palestinians to attain a captive Israeli civilian and the bodies of three soldiers.

Elhanan Miller
Jerusalem

Guns and militiamen

SIR – Your article on gun rights in America made the common assumption that the constitution is unclear on the matter ("The Supreme Court opens fire", June 28th). But its meaning would have been perfectly clear during the revolutionary era. Most recruits in the Continental Army were farmers who were too poor to own a musket, often made by local gunsmiths. Not many town dwellers owned guns either. A study of the estate records of the time listed very few muskets among the possessions of the deceased colonists.

The framers of our constitution were aware of the difficulty in getting army recruits to go through the 14 actions that were required in the infantry drill regulations to have them load, form a line and fire upon the redcoats. In case of future trouble and to make it easier to whip recruits into shape, the framers made it every citizen's right to own a weapon. A "well regulated" (read well-trained) troop could fire three rounds a minute at the enemy versus one round a minute from poorly trained men.

Wells Lange
Lieutenant-colonel, United States army (ret.)
Lafayette, Colorado

Over a barrel

SIR – If, as you assert, speculators are not responsible for rising oil prices, how is it that in a two-day period recently oil dropped by $8 per barrel ("Don't blame the speculators", July 5th)? Did the demand for oil drop so much in such a short time? Did we find some new reserves somewhere that caused the markets to suddenly discount the price of oil? Speculators are, at the very least, partially to blame for current oil prices; once they head for the exits we should see prices come down.

Daniel Berglund
St Louis, Missouri

SIR – It seems that you want it both ways. First you said that futures trading has no effect on the price of spot oil, then that speculators benefit producers and users by allowing them to hedge prices. That is like saying you have no effect on a game by hitting the ball.

Franz Amussen
Salt Lake City

In politicians we distrust

SIR – I'm afraid the hypothesis that an American would relocate to a town because of an ideological affinity with its congressman severely overestimates our enthusiasm for elected officials (Letters, July 5th). The fact is that most Americans vote not for but against a politician. We are not that enamoured of them and we are certainly not enthralled enough to up sticks and move. We would rather remain where we are and vote against an incumbent than transplant ourselves to a district that has a more like-minded representative. Assuming otherwise, to adapt the phrase, is to put the cart before the jackass.

Adam Yore
Treasure Island, Florida

Turkey’s future

Flags, veils and sharia

Jul 17th 2008 | ANKARA, KARS AND TOKAT
From The Economist print edition

EPA



Behind the court case against Turkey’s ruling party lies an existential question: how Islamist has the country become?

A MARBLE fountain held up by bare-breasted maidens in the eastern city of Kars is a source of pride for the city’s mayor, Naif Alibeyoglu. Yet last November the sculpture vanished a few days before a planned visit to Kars by Turkey’s prime minister, Recep Tayyip Erdogan. Fearful of incurring the wrath of Mr Erdogan and his mildly Islamist Justice and Development Party (AKP), the mayor (himself an AKP man) reportedly arranged for its removal.

In the event, the prime minister never arrived—and the fountain came back. The incident may be testimony to the prudery of Mr Erdogan, and of the AKP more broadly. But could it also be evidence of their desire to steer Turkey towards *sharia* law? The country’s chief prosecutor, Abdurrahman Yalcinkaya, might say so. In March he petitioned the constitutional court to ban the AKP and to bar Mr Erdogan and 70 other named AKP officials, including the president, Abdullah Gul, from politics, on the ground that they are covertly seeking to establish an Islamist theocracy.

Turkey has been in upheaval ever since. After hearings earlier this month, a verdict is expected soon, maybe in early August. Most observers expect it to go against the AKP. Turkey has banned no fewer than 24 parties in the past 50 years, including the AKP’s two forerunners. In 23 of these cases, the European Court of Human Rights ruled that the bans violated its charter.

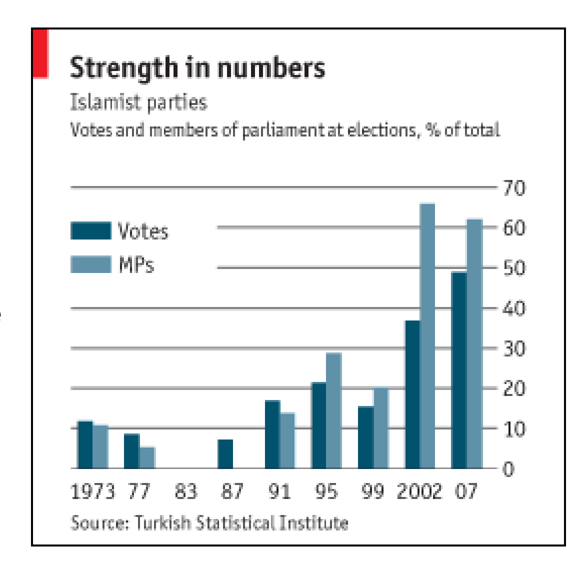
Yet Mr Yalcinkaya’s indictment lacks hard evidence to show that the AKP is working to reverse secular rule. Much of his case rests on the words, not the actions, of Mr Erdogan and his lieutenants. Among Mr Erdogan’s listed “crimes” is his opinion that “Turkey as a modern Muslim nation can serve as an example for the harmony of civilisations.” That is hardly a call for *jihad*. The AKP has promoted Islamic values, but it has never attempted to pass laws inspired by the Koran.

None of this seems to impress Turkey’s meddlesome generals, who are widely believed to be the driving force behind the “judicial coup” against the AKP. This follows the “e-coup” they threatened last year by issuing a warning on the internet against making Mr Gul president. Some renegade generals are also involved in the so-called Ergenekon group; 86 members were charged this week with plotting a coup (see article).

The generals and their allies believe that nothing less than the future of Ataturk's secular republic is at stake. Similar rumblings were heard when the now defunct pro-Islamic Welfare party first came to power in 1996. It was ejected a year later in a bloodless "velvet coup" and banned on similar charges to those now levelled at the AKP. But with each intervention the Islamists come back stronger.

Unlike their pro-secular rivals, Islamists have been able to reinvent themselves to appeal to a growing base of voters. Nobody has done this more successfully than Mr Erdogan with the AKP. An Islamic cleric by training, Mr Erdogan became Istanbul's mayor when Welfare won a municipal election in 1994. He was booted out in 1997, and jailed briefly a year later for reciting a nationalist poem in public that was deemed to incite "religious hatred".

It was a turning-point. Mr Erdogan defected from Welfare with fellow moderates to found the AKP in 2001. He and his friends said that they no longer believed in mixing religion with politics and that Turkish membership of the European Union was the AKP's chief goal. And when the AKP won the general election of November 2002, it formed a single-party government that did something unusual for Turkey: it kept its word.



The death penalty was abolished; the army's powers were trimmed; women were given more rights than at any time since Kemal Ataturk, the founder of the secular Turkish state, made both sexes equal before the law. Despite Mr Erdogan's calls for women to have "at least three children", abortion remains legal and easy. This silent revolution eventually shamed the EU into opening formal membership talks with Turkey in 2005, an achievement that had eluded all the AKP's predecessors in government.

The government's economic record was impressive, too. The economy bounced back from its nadir in 2001, growing by a steady average annual rate of 6% or more. Inflation was tamed (though it has crept back up recently). Above all, foreign direct investment, previously paltry, hit record levels. For a while, Turkey seemed to have become a stable and prosperous sort of place. That is surely why 47% of voters backed the AKP in July 2007, a big jump from only 34% in 2002.

Many see the campaign to topple the AKP as part of a long battle pitting an old guard, used to monopolising wealth and power, against a rising class of pious Anatolians symbolised by the AKP. Others say it is mostly about an army that believes soldiers, not elected politicians, should have the final say over how the country is run.



Yet the real struggle "is between Islam and modernity", says Ismail Kara, a respected Islamic theologian. Adapting to the modern world without compromising their religious values is a dilemma that has long vexed Muslims. For Turkey the challenge is also to craft an identity that can embrace all its citizens, whether devout Muslims, hard-core secularists, Alevis or Kurds. If the generals had their way, everyone would be happy to call himself a Turk, all would refrain from public displays of piety and nobody would ever challenge their authority. But the Kemalist straitjacket no longer fits the modern country. Opinion polls suggest that most Turks now identify themselves primarily as Muslims, not as Turks. The AKP did not create this mindset: rather, it was born from it.

The caliph of Istanbul

Islam has been intertwined with Turkishness ever since the Ottoman Sultan adopted the title of “Caliph”, or spiritual leader, of the world’s Muslims almost six centuries ago. When Ataturk abolished the caliphate in 1924 and launched his secular revolution, he did not efface piety; he drove it underground. Turkey’s brand of secularism is not about separating religion from the state, as in France. It is about subordinating religion to the state. This is done through the *diyanet*, the state-run body that appoints imams to Turkey’s 77,000 mosques and tells them what to preach, even sometimes writing their sermons.

In the early days of Ataturk’s republic, the façade of modernity was propped up by zealous Kemalists, who fanned out on civilising missions across Anatolia. They would drink wine and dance the Charleston at officers’ clubs in places like Kars. “My grandmother, she told me about the balls, the beautiful dresses. Kars was such a modern place then,” sighs Arzu Orhankazi, a feminist activist. In truth, life outside the cities continued much as before: deeply traditional and desperately poor.

A big reason why Anatolia seemed less Islamist in the old days is because it was home to a large and vibrant community of Christians. But this demographic balance was brutally overturned by the mass killings and expulsions of Armenians and Greeks in the late 19th and early 20th centuries. Take Tokat, a leafy northern Anatolian town where Armenians made up nearly a third of the population before 1915. The only trace that remains of a once thriving Armenian community is a derelict cemetery overgrown with weeds and desecrated by treasure-hunting locals.

Much of this history is overlooked by the secular elite. Pressed for evidence of creeping Islamisation under the AKP, they point to the growing number of women who wear the headscarf, which is proscribed as a symbol of Islamic militancy in state-run institutions and schools. Mr Erdogan’s attempt to lift the ban for universities, which was later overturned by the constitutional court, is a big part of Mr Yalcinkaya’s case against him and the AKP.

Yet surveys suggest that, except for a small group of militant pro-secularists, most Turks do not oppose Islamic headgear, least of all in universities. Its proliferation probably has little to do with Islamist fervour, but is linked to the influx of rural Anatolians into towns and cities. The exodus from the countryside accelerated under Turgut Ozal, a former prime minister who liberalised the economy in the early 1980s. For conservative families, covering their daughters’ heads became a way of protecting them in a new and alien world.

Once urbanisation is complete the headscarf will begin to fade, says Faruk Birtek, a sociologist at Istanbul’s Bogazici University. Bogazici was always refreshingly unbothered by students with headscarves. But the rules were tightened in the 1990s. And around the time the constitutional court in June overturned the new AKP law to let women with headscarves attend university, Bogazici’s liberal female director was squeezed out.

Like many, Summeye Kavuncu, a sociology student at Bogazici, has been caught in the net. She complains that her stomach “gets all knotty each time I go to university. I no longer know whether to keep my scarf on or to take it off. The secularists look upon us as cockroaches, backward creatures who blot their landscape.” Few would guess that Ms Kavuncu belongs to a band of pious activists who dare to speak up for gays and transvestites.

Social and class snobbery may partly drive the secularists’ contempt for their pious peers. But it is ignorance that drives their fear. Bridging these worlds can be tricky, “because Islam is not like other religions, it’s a 24-hour lifestyle,” comments Yilmaz Ensaroglu, an Islamic intellectual. “Devout Muslims pray five times a day.”

Wine, women and schools

The biggest fault-lines in Turkey’s sharpening secular/religious divide concern alcohol, women and education. When Welfare rose to power in the 1990s, one of its first acts was to ban booze in restaurants run by municipalities under its control. Party officials argued that pious citizens had the right to affordable leisure space that did not offend their values. Some AKP mayors have pushed this line further. They want to exile drinkers to “red zones” outside their cities. A newly prosperous class of devout Muslims is creating its own gated communities, and a growing number of hotels boast segregated beaches and no liquor. A survey shows that the number of such retreats has quadrupled under the AKP. Taha Erdem, a respected

pollster, says the number of women wearing the turban, the least revealing headscarf of all, has quadrupled too.

All this is feeding secularist paranoia about creeping Islam. Are these fears justified? In the big cities conservative Anatolians are expanding their living space. But this is not at the secularists' expense. Life for urban middle-class Turks, and certainly for the rich, continues much as before. It is in rural backwaters that freewheeling Turks fall prey to what Serif Mardin, a respected sociologist, calls "neighbourhood pressure". For instance, Tarsus, a sleepy eastern Mediterranean town (and birthplace of St Paul), made headlines recently when two teenage girls were attacked by syringe-wielding assailants who sprayed their legs with an acid-like substance because their skirts were "too short".

Habits in the workplace are changing too. Female school teachers have been reprimanded for wearing short-sleeved blouses. During the Ramadan fast last year the governor's office in Kars stopped serving tea for a while. Secular Turks contend that Islam will inevitably wrest more space from their lives and must be reined in now. With no credible opposition in sight, many look to the army as secularism's last defender.

So do many of Turkey's estimated 15m Alevis, who practise an idiosyncratic form of Islam: they do not pray in mosques, they are not teetotal and their women do not cover their heads. The government has not kept its promise formally to recognise Alevi houses of worship, called *cemevler*. Nor has it heeded Alevi demands for their children to be exempted from compulsory religious-education classes that are dominated by Sunni Islam. "There is a systematic campaign to brainwash us, to make us Sunnis," complains Muharrem Erkan, an Alevi activist in Tokat.

The battle for Turkey's soul is being waged most fiercely in the country's schools. Egitim-Sen, a leftist teachers' union, charges that Islam has been permeating textbooks under the AKP. Darwin's theory of evolution is being whittled away and creationism is seeping in. Islamist fraternities, or *tarikat*, continue to ensnare students by offering free accommodation. The quid pro quo is that they fast and pray, and girls cover their heads.

Yet the biggest boost to religious education came from the army itself, after it seized power for the third time in 1980. Communism was the enemy at the time, so the generals encouraged Islam as an antidote. Religious teaching became mandatory. Islamic clerical-training schools, known as *imam hatip*, mushroomed.

Another example of how army meddling goes awry is Hizbullah, Turkey's deadliest home-grown Islamic terrorist outfit. Hizbullah (no relation to its Lebanese namesake) is alleged to have been encouraged by rogue security forces in the late 1980s to fight separatist PKK rebels in the Kurdish south-east. The group spiralled out of control until police raids in 2001 knocked it out of action. But not entirely. Former Hizbullah militants are said to have regrouped in cells linked to al-Qaeda, and took part in the 2003 bombings of Jewish and British targets in Istanbul.

Banning the AKP could strengthen the hand of such extremists, who share the fierce secularists' belief that Islam and democracy cannot co-exist. If instead the AKP stayed in power, that would bring Islamists closer to the mainstream. "Six years in government has tempered even the most radical AKP members," comments Mr Ensaroglu. True enough. AKP members of parliament wear Zegna suits and happily shake women's hands; their wives get nose jobs and watch football matches; their children are more likely to study English than the Koran.

Had Mr Erdogan made an effort to reach out to secular Turks, "we might not be where we are today," concedes a senior AKP official. He missed several chances. The first came last autumn when the AKP was trying to patch together a new constitution to replace the one written by the generals in the 1980s. Mr Erdogan never bothered to consult his secular opponents. He ignored them again when passing his law to let girls wear headscarves at universities. Critics say that his big election win turned his head. "Erdogan accepts no advice and no criticism," whispers an AKP deputy. "He's become a tyrant."

Maybe he has. But that does not mean he deserves to be barred from politics, and his party banned.

Plots and counterplots

Coup de grâce

Jul 17th 2008 | ISTANBUL
From The Economist print edition

A case is also brought against those planning a coup against the government

WHAT do a retired general, a business tycoon, a convicted murderer and a rabbi have in common? They may all be part of an ultra-nationalist gang called Ergenekon that is bent on overthrowing Turkey's AKP government. Its modus operandi is allegedly to spread disinformation, plant bombs, kill prominent citizens and foment such mayhem that the army will intervene.

On July 14th prosecutors charged 86 people with being involved in plotting against the AKP. Aykut Cengiz Engin, Istanbul's chief prosecutor, said the group's alleged crimes included the murder of a secular judge in Ankara in 2006 by a gunman who said he was avenging a court ruling against the Islamic headscarf. Mr Engin said a long indictment would be brought before an Istanbul court, which has a fortnight to decide whether to take the case.

Ergenekon (the name of a mythical homeland from which Turkic tribes were led by a she-wolf) has riveted the public ever since a cache of weapons was found in a retired officer's basement in Istanbul. Some of them bore army serial numbers. Yet many believed the affair would be hushed up, like earlier scandals that exposed the links between security officials and organised crime.

Then in June came the mass arrests of around 50 people said to be involved in Ergenekon, among them a shady retired general, Veli Kucuk. Mr Kucuk is alleged to have had a hand in the extra-judicial killings of Kurdish nationalists in the 1990s. More recently his name was linked to the murder of Hrant Dink, an outspoken ethnic Armenian editor, in Istanbul last year. The stakes were raised on July 1st with the arrest of two more retired generals for allegedly plotting two abortive coups against the AKP in 2004 . Details of the plans were found in the leaked diaries of a former navy commander. Prosecutors are preparing a separate indictment against the men, and the army is co-operating.

This confounds the popular theory that Ergenekon is part of the struggle between the AKP and the top brass. Indeed, exhilarated liberals say the case proves that the army is no longer untouchable. But some doubt it. A columnist for *Milliyet*, a daily, reminded readers about a coup-maker "who darkened millions of lives". She was referring to Kenan Evren, the army chief who led the 1980 coup. He now lives in a seaside village painting nudes. Sacit Kayasu, a lawyer who tried to bring the ex-general to justice in 2000, has been struck off.

The Hispanic vote

¡Voten por mi!

Jul 17th 2008 | SAN DIEGO
From The Economist print edition

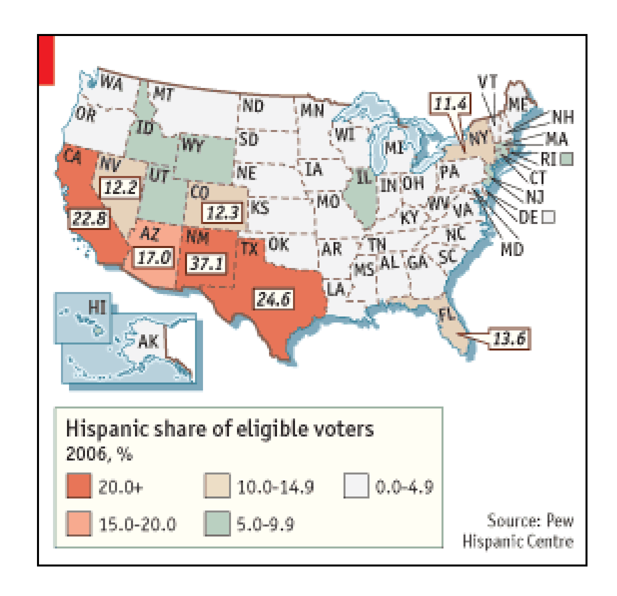
Latino voters are turning away from John McCain. That's a symptom of a bigger problem for Republicans

AP



ONE of the dilemmas facing those who spoke at the National Council of La Raza this week was how to pronounce the Hispanic activist group's name. The first syllable of the word *raza* (race, or people) requires a tricky, un-English tongue movement. Some of the anglophone speakers who tried it sounded as though they were about to choke. John McCain made no attempt at all, pronouncing the "R" like the last letter of "Budweiser". Barack Obama, by contrast, breezed through the word as if he had grown up eating *sopaipillas*. Then, to show off, he did it again.

Although less numerous than black voters, Latino voters may tip this year's presidential election. They make up 12% of the electorate in Colorado and Nevada, 14% in Florida and 37% in New Mexico (see map). In 2004 George Bush won all four of those states by five percentage points or less, and all four of them are regarded as key battlefields this time around. Florida, as the fourth-biggest state in the union and electorally one of the closest, is a place where the large Hispanic vote could well prove decisive: Jeb Bush, the president's brother and the governor of Florida at the time of the 2000 and 2004 elections, has a Hispanic wife and helped boost the Republican's share of the Latino vote there. But he is now gone.



Across the border states and beyond, Spanish-language radio stations are pushing listeners to become citizens and register to vote, apparently to some effect. Last week the Department of Homeland Security revealed that 122,258 Mexicans became citizens in 2007—up 59% from 2005.

Another difference between Hispanic and black voters (who the candidates also addressed this week, at a meeting of the National Association for the Advancement of Coloured People) is that neither party can depend on them. George Bush keenly courted Latinos, in part by appealing to their socially conservative instincts. He won at least 40% of the Hispanic vote in 2004. "I know how powerful this community is," said Mr Obama on July 13th. "And, by the way, so does John McCain."

Until recently it seemed as though the latter might be able to match or even exceed Mr Bush's haul. A series of unpatriotic, much-televised statements by Mr Obama's pastor had greatly offended a group that came to America willingly. Hillary Clinton had won the great majority of Hispanic votes in the Democratic primaries. Mr McCain represents a heavily Hispanic state and has often called for America's roughly 12m illegal immigrants to be treated sensibly and humanely.

Unfortunately, though, Mr McCain is a Republican. Hispanics share the general current contempt for Mr Bush's party, and have a few grievances of their own. It was, after all, Republicans who wrecked a bill last year that would have allowed most illegal immigrants to become citizens. It was Republicans who ran television ads in 2006 comparing labourers who stole across the Mexican border to terrorists. As the other candidates tacked to the right during the primaries, the Arizona senator at first hesitated and then seemed to follow. In January he was asked whether he still supported the immigration bill he had helped craft. No, he said.

McCain's mountain to climb

These days pollsters put Mr Obama 30 points ahead of Mr McCain among Hispanic voters. Largely because of them, he has opened a small lead in Colorado and New Mexico (plus a huge one in solidly Democratic California). Latinos have even helped Mr Obama close to within ten points in the Republican redoubt of Texas. Mr McCain had the chance to reverse the slide this week—the third time in just over a fortnight that he had addressed a big Hispanic organisation. He not only failed to do so, but at times seemed to concede the Latino vote. "I know many of you are Democrats, regrettably," he told 2,000 listeners in San Diego.

Whereas Mr Obama promised quick action on immigration reform, the Arizona senator simply asked the audience to trust that he would get around to it once the border has been secured, which everyone knows will take a long time if it ever happens at all. He expressed sympathy for illegal immigrants in the vaguest terms ("We cannot forget the humanity God commands of us"). He answered an anguished question about workplace immigration raids by explaining, rather loftily, that this was a symptom of a broader problem rather than a problem in itself.

The crowd, which had cheered Mr Obama, listened politely. That may not worry the Republican candidate. He was not just addressing Latinos—and nor was he simply trimming to the nativists who lurked outside with signs condemning "Juan McAmnesty". The average white American grudgingly

concedes that it is neither possible nor wise to deport 12m people. But he is angry with illegal immigrants for flouting the law, and wants the border fixed. So do many Latinos, particularly those (like Florida's Cubans) whose right to live in America has never been questioned.

In his pursuit of Hispanic voters, Mr Obama is straying to the left of mainstream opinion. His speech on July 13th hinted at a distaste for workplace raids and did not mention the many illegal immigrants who have committed crimes. During the primary race he expressed support for a plan by Eliot Spitzer, then the governor of New York, to allow illegals to apply for driving licences. This is the sort of thing that rattles independent voters and fires up the Republican base.

Yet Mr Obama's strength among Hispanic voters does not just have to do with his position on immigration. Nor does Mr McCain's weakness have to do with his stance on the subject. Much of the talk at the National Council of La Raza was about issues like foreclosure, school dropout rates and health insurance. Downstairs, in the convention hall, one of the busiest stalls offered advice on diabetes. Latinos worry more than most about these things, but they are not the only people who worry about them. Mr McCain's real problem is that he has so far failed to convince Americans, Hispanic or otherwise, that he can come up with solutions to their rather ordinary problems.

Business and the election

Which way will capital vote?

Jul 17th 2008 | ALBUQUERQUE, NEW MEXICO
From The Economist print edition

Business-minded voters have doubts about both candidates

FOR a short while in his early 20s, Barack Obama edited reports in New York for Business International, a publishing firm that was later bought by The Economist Group. He did not much like it, so he quit to become a community organiser. That was his only first-hand experience of business. John McCain has had even less, having spent his adult life as a pilot, prisoner-of-war and politician. Businesspeople might wonder if either candidate truly understands their worries.

Both men are happy to take money from businesspeople, and both praise enterprise in the abstract. But both also snipe at supposed corporate villains. Mr Obama spent his primary campaign railing against oil firms, irresponsible mortgage lenders and overpaid bosses who export American jobs. Mr McCain fulminates pointlessly about oil speculators, and once dismissed a Republican rival, Mitt Romney, a successful businessman, by sneering: “I led…not for profit but for patriotism.”

Both men should be careful. Some 10.7% of registered voters own a small business—only a whisker less than the 11.9% who belong to a union. Directly or indirectly, private firms pay most people’s wages. Pro-business voters cannot be ignored, and they have doubts about both candidates.

Mr Obama posed as a protectionist during the Democratic primaries (though he has since toned down his rhetoric), and he backs populist notions such as a windfall tax on oil firms. On the other hand, he seems open to advice from serious corporate types. Mr McCain is a proud free-trader and longtime opponent of red tape, whose voting record earned a 100% rating from the US Chamber of Commerce last year to Mr Obama’s 33%. But Mr McCain sounds less assured than his young rival when grappling with complex economic issues such as the housing crunch. Business lobbies admit they have no idea who their members will vote for.

What they do know is that their members are gloomy. According to American Management Services, a consultancy, 81% of small-business owners think the economy is in recession. The National Federation of Independent Business, a lobby group, says small-business confidence is at its lowest ebb in three decades. The big worry is inflation, especially of health-care and energy costs.

Health-insurance costs for small businesses have risen by 130% since 1999, causing wages to stagnate and many firms to restrict or eliminate coverage. Mr McCain wants to curb costs by allowing more competition, and to give tax breaks for health insurance to individuals rather than companies. Mr Obama promises subsidies to make coverage nearly universal and to tax big firms that don’t cover their employees. Both plans have drawbacks, says Bruce Josten of the Chamber of Commerce. Few people will buy individual insurance policies under Mr McCain’s plan, he predicts, and Mr Obama’s does not do enough to restrain costs.

The exploding price of oil, meanwhile, cripples transport firms and fuels inflation for everything that has to be moved around. In the short term, neither candidate can do much. In the long term, Mr Obama favours huge public investment in alternative energy. Mr McCain favours some subsidies, but places more emphasis on private investment and nuclear power.

The two candidates differ sharply on taxes. Mr Obama would raise taxes on capital gains, dividends and incomes over $250,000 a year. Mr McCain offers a seemingly more enticing package of cuts in corporate income tax, ordinary income tax and inheritance taxes. But some doubt that he will curb spending enough to make the package fiscally responsible.

Some of Mr Obama’s friends spook business. Whereas Mr McCain supports curbs on frivolous lawsuits, trial lawyers back Mr Obama with open wallets. Mr Josten says business should be “very concerned” that a President Obama would roll back tort reforms, though as a senator he once voted for a mildly reformist

bill. Mr Obama also wants to end the requirement that workers hold a secret ballot before forming a union. Besides being undemocratic, this alarms many employers.

With less than four months to the election, many businesspeople are undecided. A recent poll of small-business owners found that 80% had little idea what either candidate might do for them. Dave Bromberg, a grocer in Albuquerque, says he likes both of them. He thinks Mr McCain is tough on waste but Mr Obama would have trouble standing up to a free-spending Democratic Congress. “Democrats feel sorry for everybody,” he says. “McCain will probably say, hey, we’re all responsible for ourselves, and [the government] will help you a little bit, but only a little.”

Iraq and Afghanistan

In the line of fire

Jul 17th 2008 | WASHINGTON, DC
From The Economist print edition

Barack Obama describes his war aims which are still rather vague

AP



Some mistook it for a photograph

IN 1960 John F. Kennedy won the presidency by, in part, making the counter-intuitive argument that his Republican opponents had been too soft on the Soviet Union. Nearly half a century later, Barack Obama seemed this week to be trying something of the same sort.

On July 15th Mr Obama appeared on a stage with no fewer than eight American flags, not to mention the one he has recently started wearing on his lapel. He had his work cut out. Ever since he spoke of "refining" his plans for pulling out of Iraq, liberals have assailed him for backing away from his commitment to all but leave Iraq within 16 months of taking office. Centrists hoped he would further soften his determination to pull out quickly. And whichever way he went, conservatives would criticise him: for flip-flopping if he moved towards the centrists, or for ignoring the success of the American "surge" if he satisfied the left. The right, not known for its love of satire, was already particularly thrilled by the cover of this week's *New Yorker,* which shows Mr Obama and his wife dressed as terrorists.

Bravely, Mr Obama chose to go on the offensive. Iraq, he said, has been a distraction from a myriad of more immediate threats—from radical Islamists in Afghanistan and Pakistan to loose nuclear material to cracking roads in America. Rather than simply focusing on Iraq, as John McCain tends to do, he talked of securing and rebuilding Afghanistan. Mr Obama said that he would redeploy two additional brigades there, along with more helicopters and predator drones, before the country becomes any more chaotic.

Mr Obama also said he would triple non-military aid to Pakistan while pressing the government to assert more control of its border regions. If the government failed to do so, he repeated an earlier threat to use American means to hit targets without Pakistan's permission. He would expand the armed forces, double foreign aid and rule out no tool with which to coerce Iran. He also repeated his pledge to start withdrawing from Iraq the day he takes office, and largely to complete the job in 16 months.

The McCain campaign promptly counter-attacked, saying that Mr Obama was wrong to discount the surge and mistaken in his desire to withdraw troops quickly. The Republican's foreign-policy team gleefully pointed out that Mr Obama has not even visited Iraq this year to witness the fruits of the surge. He is about to do so, though the details of his trip remain mysterious; some people think it odd that he made his big speech before heading off on a trip to the two countries, rather than after finding out the facts there. And the McCainites duly touted their own plan for Afghanistan, which calls for the deployment of three fresh brigades to the country. Winning in Afghanistan, Mr McCain argued, does not require losing in Iraq.

In fact, Mr Obama's plan to shift America's priorities towards Afghanistan probably depends on winning in Iraq if it is to succeed. He would find it much harder to repair America's alliances while clamping down on Iran and putting pressure on Pakistan if he were to let Iraq lapse into chaos by withdrawing the bulk of America's force there precipitately. Mr Obama still hints that he understands that. He spoke this week of making "tactical adjustments" to his plans as conditions in Iraq change. That leaves him a little room to keep troops in a bit longer.

Whether out of good sense or political calculation, Mr Obama is continuing to keep his Iraq options open. That won't satisfy his leftish base, and it can only be mildly heartening to moderates, who are left to guess in what circumstances he might amend his 16-month timetable. Fashioning himself as a muscular internationalist in other areas will not easily free Mr Obama from that political quagmire.

Wind power

Turbine time

Jul 17th 2008 | AUSTIN
From The Economist print edition

T. Boone Pickens takes to the skies

AP



A rosy future for wind

AMERICANS spend $700 billion a year on foreign oil. According to one observer, this is an addiction, a crisis, and a trap. The country must pursue alternative energy sources as fiercely as it once shot for the moon. So far, so much liberal boilerplate. The critic in question, however, is a Republican oilman: T. Boone Pickens. As he puts it, in an Okie drawl: “I've been an oilman all my life. But this is one emergency we can't drill our way out of.” He wants America to make a huge investment in wind-power infrastructure. During this election season, he will personally spend $58m to make the case.

Mr Pickens's interest is not solely altruistic. His company, Mesa Power, has already invested $2 billion to build the world's largest wind farm in Pampa, a small town in the Texas panhandle. He told a Senate committee in June that he is going to pay for the transmission lines that will carry Pampa's power to the Dallas area because he cannot wait for the state to build the infrastructure. As he likes to point out, he is 80 years old and worth $4 billion. So profit is not the only issue, either.

A report from the Department of Energy said in May that America could build enough wind farms to provide 20% of the nation's electricity by 2030. The Pickens plan calls for America to meet this goal by building wind farms throughout the windy corridor that runs up the country from Texas to the Dakotas. It would cost $1 trillion to build them, plus another $200 billion to connect them to places where the power is most needed, which lie inconveniently far away from the corridor.

That is a staggering outlay, but it would free up American natural gas, which now generates 22% of the country's electricity, to be used for motor vehicles. The idea is that Americans could switch en masse to natural gas vehicles, and the country could stop importing so much oil.

As a bonus, says Mr Pickens, the industry would create jobs and revitalise rural America. He points to the west Texas town of Sweetwater to prove his point. Ten years ago it was just one more struggling speck on the prairie. Its only excitement was an annual rattlesnake round-up. Then the wind industry started to take hold in west Texas and the panhandle. Locals initially fretted that the turbines would be too noisy. They also worried that they would mar the vast horizon. Other west Texans are less enamoured of the original view. “The landscape is an eyesore,” counters a man from Groom.

In any case, the turbines look nicer as the benefits accrue. In 1999 the state's wind power capacity was just 180 megawatts. Today Texas leads the nation with almost 5,000. Most of that is concentrated in the north-western quarter of the state. The economic impact on Nolan County, which encompasses

Sweetwater, will be $315m this year. Wind has brought more than 1,000 new jobs to town.

This boomlet has made an impression on Texans. Wind power accounts for 3% of the state's electricity, compared with 1% nationwide. But the tax credit that has been driving its growth is about to expire. And then there is the question of the creaking grid. The state is mulling a plan that would enable the transmission of 17,000 additional megawatts at a cost of $6.4 billion.

Building wind power capacity will not be an easy task. But there is an emerging agreement in Texas that it is worth the trouble. That is where Mr Pickens can make a difference. His plan is undeniably quirky. Its emphasis on natural gas is strange, for one thing: America does not have many natural gas vehicles. But if Mr Pickens wants to use his own fortune to sell the general public on the idea of wind power, that is all to the good. No one can accuse him of being a soft-headed tree-hugger.



Measuring poverty

The Big Apple gets poorer

Jul 17th 2008 | NEW YORK
From The Economist print edition

The federal definition of poverty is challenged by local government

Illustration by Claudio Munoz



FED UP with the slow-moving federal government, America's local municipalities and states have recently launched many reform plans themselves, including health care (Massachusetts's universal health initiatives) and global warming (California's emissions caps). New York City, already a model in policing and an emerging one in school reform, is now tackling poverty. To fight it properly you need good figures; as the late Senator Daniel Patrick Moynihan once said, "you can't solve a problem until you can measure it." So Michael Bloomberg, New York's mayor, announced on July 13th an alternative to the federal poverty measure.

This measure, now 40 years old, assesses pre-tax cash income against a number of thresholds, based primarily on food spending. But this has decreased from one-third to one-eighth of average household spending over the past four decades. Housing, which now makes up more than 30% of family expenditure, is not taken into account. Nor are regional cost-of-living differences. A two-bedroom apartment, for instance, costs $1,318 a month in New York City and $1,592 in San Francisco, contrasting sharply with the national average of $867 and one Mississippi county's $498. On the income side, non-cash benefits such as subsidised housing and food stamps, are ignored. So is the earned-income tax credit, a wage subsidy geared towards the working poor.

The new formula is based on recommendations made at Congress's request in 1995 by the National Academy of Sciences, but never implemented federally. Defining who is poor is a touchy subject. The NAS measures reflect spending on food, clothing, shelter and utilities, which are assumed to equal about 80% of median family expenditures. Adjustments are made for transport costs, child care and out-of-pocket medical costs.

This measure increases the numbers of New York's poor, from 19% of the population to 23%. Under the new calculus, the new poverty line for a family of four is $26,138, not the official federal level of $20,444. The new measure reveals that a smaller number of New Yorkers live in extreme poverty, but shows a higher proportion of working poor—and a shocking poverty rate among the elderly: 32%, compared with the federal estimate of 18%.

The mayors of Los Angeles, Miami and Cincinnati have praised New York's boldness. Congress may also be inspired to change the national poverty formula, and was due to start hearings on July 17th.

Poverty is an important part of Mr Bloomberg's agenda. He set up the Centre for Economic Opportunity (CEO) in 2006 specifically to reduce it. The centre created Opportunity NYC, America's first experiment in tying some benefits to conditions, such as turning up for parent-teacher meetings, having health-insurance or even going to the dentist. Last month it opened a financial-counselling centre for poor folk in the Bronx. Now the task of tackling poverty can truly get started.



Schools and unions

Learning their lesson

Jul 17th 2008 | CHICAGO AND NEW YORK
From The Economist print edition

Can a teachers' union be an engine for reform?

THE election on July 14th of Randi Weingarten as president marks a new era for the American Federation of Teachers (AFT), or so the union says. For years teachers' unions have been demonised as the main obstacles to school reform, often with good reason. Now the AFT is billing Ms Weingarten as a "reform-minded advocate". With American students lagging, Ms Weingarten insists that "the union is the solution." She has some convincing to do.

If any teachers' union were to promote reform, it would be the AFT, America's second-biggest. While the larger National Education Association has historically been less nimble, the AFT's president from 1974 to 1997, Al Shanker, supported accountability and even some pay-for-performance schemes. ("I used to shy away from bribery," he reportedly said, "but I've come to the conclusion that it has a place.") Today the AFT supports such bonuses, if negotiated with a local union. It also represents teachers in more than 70 charter (publicly funded but self-governing) schools, in ten states.

As for Ms Weingarten, her outspoken reign as union president in New York City provides a mixed picture. Michael Bloomberg, the mayor, has pursued radical reform. Ms Weingarten has said she favours "sustainable and incremental change". As others applauded Mr Bloomberg, Ms Weingarten was a loud heckler. A former lawyer and history teacher, she even filed a lawsuit against the city.

Still, faced with a mayor intent on turning the system on its head, Ms Weingarten proved a skilful acrobat. She agreed to a longer school day in exchange for better pay. After originally fighting the mayor's plans for charter schools, she has launched two of her own. (A third unionised charter will open in New York in September.) Last autumn she agreed to a plan that awards schools lump bonuses for teachers if scores improve.

Despite such signs, Mike Petrilli of the conservative Fordham Foundation eyes the AFT's foray into charter schools with caution, contending that one of the most important traits of a charter is that it is not unionised. Thanks in part to Ms Weingarten, New York now requires that if a charter has more than 250 students before its third year, its teachers must unionise.

Eva Moskowitz, who runs four charter schools in Harlem and is a former city councillor, doubts Ms Weingarten's commitment to accountability. Ms Weingarten insists that tests are important, but that George Bush's landmark law, No Child Left Behind, is "too badly broken to be fixed". In New York, she has proposed a system that values not just test scores but also factors such as curriculum, building maintenance and support from the central district. This would provide a broader look at a school, but also a cloudier one.

Joseph Walker, a Chicago teacher, surveyed the throngs at the AFT's convention on July 12th. "You can't stay the same," he explained, "you've got to modernise." Two days later Ms Weingarten outlined her vision, which includes making schools community centres with a full range of services, and encouraging districts and locals to develop new salary models. Ms Weingarten's era at the AFT may not be revolutionary, but it will be interesting.

Riverboats

Requiem for a queen

Jul 17th 2008 | ST LOUIS
From The Economist print edition

A riverine legend faces extinction

AP



Last chance to sail in her

BARRING a last minute reprieve, America's last proper paddle-wheeled steamboat may disappear by the end of the year. For decades the *Delta Queen* has been one of the most magnificent sights on the Mississippi and Ohio rivers, forging through the water as her calliope steam organ blasts merrily away.

But it looks as though the federal Coast Guard, applying the same regulations to riverboats as to ocean-going ships, will no longer allow the *Delta Queen* to carry passengers on overnight excursions. The problem is the wooden superstructure, the white wedding-cake of decks above the boat's mighty hull. In 1966 federal regulations banned any vessel with wooden superstructures from carrying more than 50 passengers on anything longer than day-trips. Congress granted the *Delta Queen* an exemption because she is never more than a few hundred yards from the safety of the river bank should a fire occur. Since then, the exemption has been extended nine times. But probably not for a tenth.

Although she seems to recall the days of Mark Twain on the Mississippi, the *Delta Queen* has a more modern history. Built in California in 1926 using a steel hull constructed in Britain, she first ran between Sacramento and San Francisco. During the second world war, she was pressed into service as a floating barracks and as a ferry in San Francisco Bay. After it, she was towed through the Panama Canal and up to her new port far inland.

The effort to renew the exemption ran into a sandbar in the shape of James Oberstar, a Democratic congressman from Minnesota, who blocked passage of a tenth exemption by the House's Transportation and Infrastructure Committee, which he chairs. Steve Chabot, who represents Cincinnati, the *Delta Queen*'s home port in Ohio, led a campaign to bypass the committee and pass a ten-year extension, but the effort failed and so far has not been renewed. In opposing any exemption Mr Oberstar cites the example of the *General Slocum*, which caught fire in New York harbour in 1904. More than 1,000 people were killed, making it the worst man-made tragedy in the city until September 11th 2001.

The *Delta Queen*'s supporters counter that she has a modern sprinkler system and is inspected by the Coast Guard six times a year. There has never been a fatality on board, and the only fire, in 2003, was started by a chafing dish and was quickly put out. The riverboat will continue to carry passengers until the exemption expires in November. She may end up as a floating hotel or a day-trip cruiser. An era will die with her.

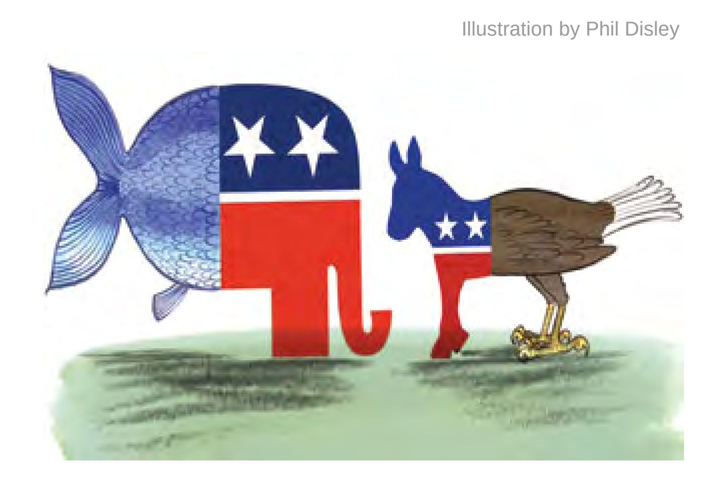
Lexington

Cobbling together a dream ticket

Jul 17th 2008
From The Economist print edition

John McCain and Barack Obama need to err on the side of caution in choosing their running-mates

Illustration by Phil Disley



THE foundations of American capitalism may be going up in flames. But no amount of dismal economic news can dull the appetite of Washingtonians for playing one of the oldest games in town—picking the candidates' running-mates. Every other day seems to bring news of one potential candidate rising (Al Gore is flavour of the moment on the Democratic side) or another one flaming out (Carly Fiorina, the former head of Hewlett-Packard, doomed her campaign for the Republican slot when she complained loudly that some health-care plans cover Viagra but not the birth-control pill, sinful to many conservatives).

This enthusiasm is partly the result of the sheer pleasure of the game. Playing the veep-stakes allows pundits to display their knowledge of obscure governors in swing states and arcane bits of political history. But the game also has a serious side. John Adams, the country's first vice-president, described the job as "the most insignificant office that ever the invention of man contrived or his imagination conceived." John Nance Garner, FDR's first vice-president, dismissed it as "not worth a pitcher of warm piss." But in recent years the urine has turned golden. Al Gore presided over high-profile programmes such as "reinventing government". Dick Cheney was almost a co-president.

The vice-presidency is the anteroom to the Oval Office. Fourteen vice-presidents have gone on to be presidents, nine of them the beneficiaries of death or resignation. Since the second world war, the majority of vice-presidents have ended up as their party's standard-bearers. A clever choice of VP can put a candidate over the top (most famously with JFK and Lyndon Johnson in 1960). A dumb one can be catastrophic. George McGovern's already troubled campaign in 1972 imploded when it turned out that his first choice for VP, Thomas Eagleton, had been given electric-shock therapy.

Some political strategists are urging the candidates to do something bold—break the rules and choose a candidate from the other party. Why doesn't Mr McCain pick Joe Lieberman, a prominent Democrat turned independent? (The senators are seen so often in each other's company that they might be Siamese twins.) And why doesn't Barack Obama pick Chuck Hagel, a Nebraska Republican and decorated Vietnam war veteran who has been one of the loudest critics of the Iraq war?

But this might prove too clever by half. Both Mr Obama and Mr McCain have already broken enough moulds without needing to break more. This sort of bold party switching would not only send the message that you think your own side is bereft of talent. It would also create a huge problem with succession. The vice-president is, among other things, a party leader in waiting.

Even more than most presidential candidates, Messrs McCain and Obama both need to err on the side of

caution. They have to bear in mind a single word in choosing their running mates—reassurance. Mr McCain (71) is the oldest candidate in American history. He needs to appoint somebody who could instantly step into his shoes. He is a maverick who grates with many hard-core conservatives. He has made it strikingly clear that economics is not his strong suit. He must compensate for that potentially fatal weakness if he is to have any chance of winning in a year when banks are failing and the mortgage market evaporating.

Mr Obama also has striking weaknesses of his own. He is a first-term senator with few legislative accomplishments and no executive experience. He has a wafer-thin foreign-policy résumé. He has trouble connecting with blue-collar America. In most primaries the party quickly coalesces around a winner. This year white working-class voters seemed to grow more sceptical of the junior senator for Illinois as the race progressed.

Of the two, Mr McCain has the easier choice. Lexington would plump for Mitt Romney, a youthful-looking 60-year-old with plenty of executive experience—a former governor of Massachusetts who rescued the Salt Lake City winter Olympics from disaster. He goes down well with many conservatives. And he is a businessman with credibility on Wall Street and an impressive record of re-engineering failing corporations. True, he is a Mormon with unreal hair, and he and Mr McCain don't like each other much. But running for the White House is not a road trip.

Obama's choice

The choice on the Democratic side is more difficult. Hillary Clinton is arguably the ideal candidate. But the combination of Bill and Hillary would spell dysfunction in the White House. And choosing her might suggest weakness on Mr Obama's part. Kathleen Sebelius is in many ways Hillary without the dark side—a successful governor of Kansas with roots in the all-important swing-state of Ohio, where her father was governor. But in an election year in which white working-class men could be the key swing vote, an Obama-Sebelius ticket would probably be too much of a good thing.

This leaves a long and impressive list of white men: foreign-policy heavyweights such as Joe Biden and Sam Nunn, current and former governors such as Bill Richardson (New Mexico), Tim Kaine (Virginia), Evan Bayh (Indiana) and party stalwarts such as Al Gore and Mark Warner, a former governor of Virginia who is currently running for his state's Senate seat.

But given this wealth of choices Mr Obama would do well to be careful: he needs someone with a delicate combination of executive experience and personal gravitas. Mr Biden likes to shoot his mouth off. Mr Nunn is anathema to liberal activists who are already furious with Mr Obama's move to the centre. Mr Richardson is too gregarious for his own good. Mr Gore may be too big for the job, in every sense. The three remaining candidates—Messrs Warner, Bayh and Kaine—may be a little on the dull side. But given Mr Obama's race and charisma, a boring white man may be exactly what he needs.

Brazil

Mending an icon

Jul 17th 2008 | RIO DE JANEIRO
From The Economist print edition

How Rio's first good governor in decades is starting to renew Brazil's most famous city

AP



IT IS not hard to discover what is wrong with Rio de Janeiro. Walk along the main shopping street of the Complexo de Alemão, a large shanty town that has been surrounded by police gunmen for months, and after about 20 metres the stalls selling fruit, vegetables and pirated DVDs give way to one selling wraps of cocaine and marijuana. It is run by boys with machineguns slung over their shoulders. Other shoppers try hard to pretend that this is normal, but they avoid looking the gunmen and their hangers-on in the eye, just in case. From time to time more machineguns pass by on motorbikes, their riders off to collect drugs, kill a rival or enforce their own version of the law.

When Sérgio Cabral was elected governor of Rio state at the end of 2006, hopes were high that he might curb corruption among politicians and the police, and pull the city of Rio (for which he is also responsible) out of a 25-year slump. He hired a team of reformers, broke a local taboo by appealing to the federal government for help, and seemed almost too eager to try new things. Inspired by the work of Steven Levitt, an American economist, he at one point suggested legalising abortion as a way of reducing the future supply of potential criminals.

A year and a half into his term, how is Mr Cabral doing? According to his finance minister, Joaquim Levy, the new government's plan was first to get the state's finances in order and then to fund improvements in health care and public security. An unspoken assumption was that Mr Cabral's administration would also practise a cleaner brand of politics.

The first part has gone well. Despite the oil money that Rio gets from the wells off its coastline, the state has often been in the red. That has changed under the new administration. Tax receipts are up: the courts that rule on tax disputes, which can go on for many years—some cases from the early 1990s are still not settled—are being streamlined with the aim of cutting the time spent wrangling to no more than two years. And spending is more controlled. As a result, the state's finances have gone from a deficit of 100m reais ($63m) to a surplus last year of 790m reais.

Mr Cabral has also been busily soliciting foreign investment to add to the deal that his predecessor signed with ThyssenKrupp, a German industrial group, to build a steel mill that is due to be the biggest foreign investment in Latin America. The time taken to register a business is falling. The state's pension fund has been under something like normal financial management and is now accumulating cash for the first time

in ten years.

However, government in Rio is mainly judged by the level of violence, and here its record is less good. After a promising start, Mr Cabral's administration fell out with reformers in the police. Brazil's murder rate has been falling, but in the city of Rio killings by the police have risen sharply—up from 300 in 1998 to 900 last year. Earlier this month two policemen opened fire on a car they thought belonged to a drug dealer, killing a three-year-old boy. The army, where it has been deployed against crime, has proved equally slapdash. Last month soldiers handed three young men from one shanty town to a gang in a neighbouring area. All were promptly murdered.

Part of Rio's problem is that voters have long shown a preference for charm over administrative skills when it comes to choosing their politicians. Anthony Garotinho, a football commentator turned tele-evangelist, and his wife Rosinha, who between them governed the state with a startling incompetence from 1999 until 2006, are the most recent examples. According to André Urani, author of a forthcoming book on the city, the explanation lies in an abdication by Rio's elite which, he argues, has regarded local politics as insufficiently important to merit its attention.

Yet even as Mr Cabral's administration seems to be breaking this pattern, there are signs of it resurfacing elsewhere. The front-runner in the mayoral race in Rio, to be held in October, is Marcelo Crivella. He is the nephew of Edir Macedo, who runs the Universal Church of the Kingdom of God, a large network of Pentecostal churches. His uncle also co-owns the Rede Record group, which includes one of Brazil's biggest news channels. Mr Crivella is a bishop in the church (he also has a career as a singer). Though this ought not to count against him in his bid to be mayor, his willingness to over-promise should. He recently got in trouble for suggesting in campaign leaflets that he could single-handedly remodel one of Rio's largest shanty towns to resemble a picturesque hillside village in Italy.

Set against this tradition, Mr Cabral's government, which is clean, competent and takes institutions seriously, is a huge improvement. Yet it is too early to declare Rio's renaissance to be under way. As the machineguns in the shopping streets attest, there is still a huge amount to do.

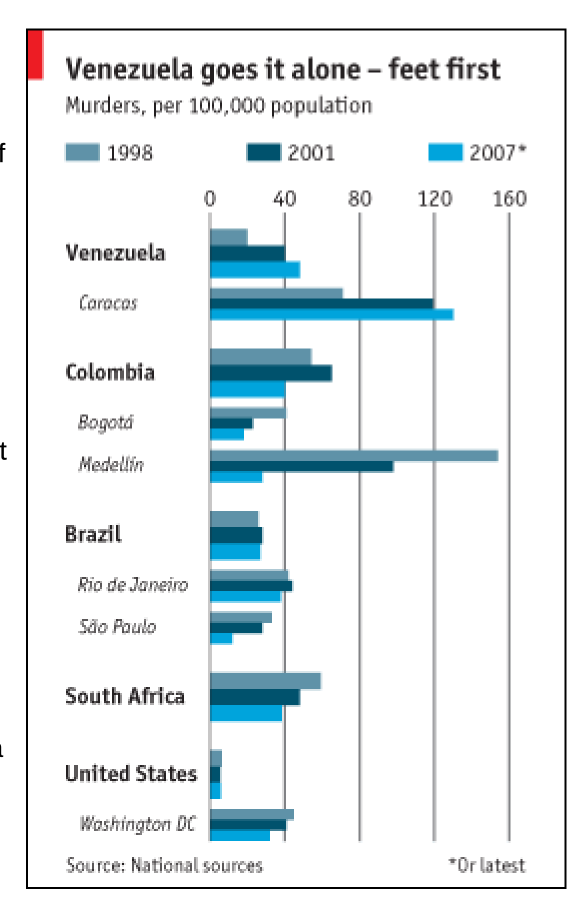
Venezuela

Deadly massage

Jul 17th 2008 | CARACAS
From The Economist print edition

How not to tackle a soaring murder rate

Get article background



ONE of Hugo Chávez's lesser-known feats since taking over as Venezuela's leader in 1999 is to have presided over a tripling of the annual homicide rate—and that's according to the official statistics. Last year more than 13,000 people were killed in a country of 27m, producing a murder rate of 48 per 100,000, the second highest in the world (after El Salvador). In neighbouring Colombia, a country plagued by guerrilla war and drug violence, the rate was 40 per 100,000.

Not surprisingly, violent crime far outweighs the other worries of Venezuelans. Three-quarters of them describe it as the worst problem now facing the country, polls show. "The first thing we need to do", says José Vicente Rangel, Mr Chávez's former vice-president, "is confess our failure."

He claims that the government, opposition, media and criminologists are all equally to blame. But, as critics point out, Mr Chávez controls most of the security forces, as well as the prisons; the courts and the prosecution service are in effect branches of the executive, too. Luis Cedeño, head of Incosec, a public-security think-tank, accuses the government of showing a "total lack of political interest" in tackling crime. But with crucial local elections due in November, even Mr Chávez has begun to worry.

A series of interior ministers (about one a year since 1999) has failed to slow the murder rate's seemingly inexorable rise. However, the present incumbent, Ramón Rodríguez Chacín, a former naval-intelligence officer, claims to have achieved a 27% drop in homicides since he took over the job in January. Few independent experts believe this to be due to anything more than a creative massaging of the figures.

Many homicides never get into the official statistics. They include those killed while supposedly "resisting arrest". Yet in exchanges of fire between police and alleged criminals, 39 suspects are killed for every policeman, suggesting not much "resistance" is taking place. Another large (and growing) group of suspicious deaths excluded from the official data are those that have not yet been categorised—and probably never will be—though most are likely to result from murder. And then there are the jail murders. Every year, two in every 100 prisoners (more than one a day) are killed, but they are left out of the statistics, too.

Although killings between rival gangs are included, they are dismissed by Mr Rodríguez Chacín as "not posing a threat to public safety". That is not much comfort to Ana Pulido, who was seriously injured by a shotgun blast when a gang of hooded criminals mistook her house, in a poor area of Caracas, for the hideout of a rival gang member. Her daughter and son-in-law were also injured. "The wound is near my spine," she says. "Now I can't stand up or lie down." The hoodlums threatened to burn down the house if she reported the incident to the police, so she refrained. They are now all dead anyway, she says, killed by their rivals.

Caracas is currently the second most dangerous city in the Americas (after San Salvador). Even by the official figures, the murder rate is 130 per 100,000; Mr Cedeño says the true figure is a staggering 166.

One reason, he argues, is impunity. On average, only three of every 100 murderers are actually sentenced, he points out. Another is a presidential discourse that emphasises class warfare and has sometimes excused crime as a response to social inequality.

The government's proposed solutions are mostly repressive. Last month Mr Chávez ordered national-guard troops with automatic rifles to protect passengers on Caracas buses in a move dismissed by crime experts as thoroughly inappropriate. Mr Cedeño prefers to advocate prevention. The recovery of public spaces, which in Caracas are mostly poorly lit and rendered inhospitable by street-trading and uncollected rubbish, would be a good start, he suggests. November's elections may help—by removing some incompetent mayors. But full-scale institutional reform may require a change of mind, or even government, at national level.

Colombia and Venezuela

Love fest

Jul 17th 2008 | CARACAS
From The Economist print edition

Presidents Chávez and Uribe agree to bury the hatchet—for now

Get article background

IT WAS the first meeting between Colombia's Álvaro Uribe and Venezuela's Hugo Chávez since relations between the two presidents turned sour last November. Forgotten, apparently, were the past recriminations and tensions that at one point had almost brought the two neighbours to the brink of war. (Mr Chávez ordered tanks to the border in March after Colombia bombed a Farc rebel camp just inside Ecuador.) Now it was all smiles and avowals of mutual love as the two presidents agreed to kiss and make up.

Even before their pow-wow on July 11th in the Venezuelan town of Punto Fijo, Mr Chávez was vowing to welcome "like a brother" the man he had recently accused of being "a mafia leader…unfit to govern Colombia" and an American pawn. In his turn, Mr Uribe had accused his neighbour of "financing genocide" because of his alleged support for Colombia's leftist rebels. But it was time, Mr Chávez declared after the talks, to "turn the page on the stormy past". A "new era" was beginning, he gushed: "We're destined to be together always." The two countries (which used to be just one) were indeed "brothers throughout history", rejoiced Mr Uribe.

It is in both leaders' interests to patch things up. Venezuela is Colombia's second most important trading partner after the United States. Colombia exported more than $5 billion of goods to Venezuela last year, almost double the total in 2006.

For Mr Chávez, the tryst may help burnish a tarnished image at home where he is facing anger over rampant inflation (now running at 32%) ahead of critical local and state elections in November. It will also help distance him from the FARC. It might even endear him to some 2m Colombian voters living in Venezuela, many of whom have been upset by his belligerence toward their president.

For Mr Uribe, the meeting was a chance to gloat over his army's spectacular rescue of 15 rebel-held hostages, including Ingrid Betancourt, a French-Colombian politician. In a clear snub to Mr Uribe, the FARC released six hostages into Mr Chávez's hands earlier this year. The handshake with the Venezuelan leader also helped mark the end of Mr Uribe's isolation in the region following his much-criticised raid into Ecuador to kill a top FARC leader.

Such deep mistrust will not be easily dispelled. But for the moment, the two leaders are at least willing to try.

India and pollution

Up to their necks in it

Jul 17th 2008 | VARANASI
From The Economist print edition

Despite good laws and even better intentions, India causes as much pollution as any rapidly industrialising poor country

Getty Images



A HEREDITARY Hindu priest, Veer Bhadra Mishra is wont, shortly after sunrise, to totter down the stone steps of his temple to the Ganges river, and there perform a three-part ritual. He touches the sacred water. He dips himself in it. He cups it in his hands and drinks it.

Mr Mishra, 70, cannot make it down to the river every day. The steps are steep. And the river-level at Varanasi, Hinduism's holiest city, where Mr Mishra is the eighth-generation custodian of a temple dedicated to the monkey-god Hanuman, has fallen. Diversion of the river-water, for industry, agriculture and dozens of upstream cities, is the cause of this. So, to save Mr Mishra's creaking knees, his acolytes sometimes bring him a morning cup of Ganges water—a cloudy brown soup of excrement and industrial effluent—to relish.

Mr Mishra has contracted typhoid, polio, jaundice and other water-borne ailments. A hydrologist turned environmental activist, he reasonably assumes that his morning devotions are to blame. By official standards, water containing more than 500 faecal coliform bacteria per 100 millilitres is considered unsafe for bathing. As it passes Mr Mishra's temple, at the upstream end of Varanasi's 6.5km (4 mile) stretch of terraced riverbank, or *ghats*, the Ganges contains 60,000 bacteria per ml.

Downstream of the *ghats*, where 60,000 devotees perform daily ablutions in the river and 32 streams of raw sewage empty into it, the figure rises to 1.5m. Two cremation grounds along the *ghats*, which dispose, wholly or partly, of 30,000 corpses a year, do not help. (Over 3,000 corpses were reported bobbing in the river last year.) In places, the Ganges becomes septic: tar-black, stinking, without life. Mr Mishra fears that Hinduism, which reveres the Ganges as "the source of life", will suffer for this. But the corporeal effects of foul water in India may be easier to measure.

By official estimates, India has facilities to treat 18% of the 33,200m litres of sewage its cities produce every day. In fact, it treats only 13%, because of shortages of power, water and technical expertise in its sewage plants. These figures may underestimate the problem: measuring the output of 700m Indians who have no access to a toilet is tricky. But it is enough to suggest why most Indian rivers, from which millions of Indians draw their water, are horribly polluted. Unsurprisingly, then, despite much progress in related areas, such as availability of safe drinking-water, an estimated 1,000 Indian children die of diarrhoeal

sickness every day. In the words of Sunita Narain, a prominent environmentalist, mocking the tourist ministry's slogan: "Incredible India, drowning in its excreta".

As India rapidly industrialises, this invites a troubling thought. By 2020, according to the World Bank, India's water, air, soil and forest resources will be under more human pressure than those of any other country. Undaunted, India plans to sustain its current high rate of economic growth without the environmental devastation that Western countries, and recently China, have wrought. Its democratic traditions, it is often said, including a free press, independent judiciary and vigorous social activism, will help prevent the damage. So should its voters: according to a survey last year by the Pew Research Centre, 79% of Indians considered pollution a "very big problem". And yet, if India cannot begin to deal with its own excrement, how will it cope with more complicated, and politically contested, hazards?

After all, its rivers are noxious despite many excellent environmental laws and regulations. Nor is a lack of money the main problem. Since 1985, and the launch of an emergency plan to save the Ganges, India has dedicated 51 billion rupees ($1.2 billion) to cleaning its rivers, mostly by urging state governments to build sewage-treatment plants beside them. The Ganges and one of its main tributaries, the Yamuna, which runs through Delhi, were allotted over half of this cash. But less than half has been spent. And the sanitation it has built would be hopelessly insufficient even if properly used, which it is not.

In Varanasi, the state government of Uttar Pradesh (UP) has built three treatment plants with a total capacity of around 100m litres of sewage a day. But Varanasi produced 150m litres when they were built, and may now produce twice this amount. Moreover, the plants rarely operate at full capacity. During frequent power cuts, the sewage flows untreated into the Ganges. During rainy seasons—around five months of each year—the river floods the plants' sump wells, with the same effect.

At least there is hope, in the shape of the activist priest, Mr Mishra. For over a decade, he has been engaged in a legal dispute with UP's government over how to fix the problem. The government wants to build more of Varanasi's current expensive and unsuccessful treatment plants. Mr Mishra, with support from the municipal government, wants a cheaper sort, designed by researchers at the University of California, Berkeley, which relies on gravity and naturally occurring bacteria and uses almost no power. On June 30th the ministry of environment, in Delhi, requested UP's rulers to abandon their plan in favour of testing Mr Mishra's.

Occasional victories by dogged activists, backed by the courts, are justly celebrated in India. A successful campaign in 2001 by Ms Narain's organisation to convert Delhi's buses and taxis from diesel to gas, and thereby reduce air pollution in the capital, was a cheering example. But these are exceptional cases amid a pervasive institutional weakness. Clueless local governments; corrupt state governments; feuding, overburdened central government: all three have played a part in the Ganges foul-up. To achieve relatively clean economic growth India will have to overcome these frailties, even as its capacity to pollute soars. Against such forces, the efforts of environmentalists to affect policies with powerful backers seem puny, and their triumphs short-lived. Alas, with 1,000 extra vehicles on its roads every day, Delhi's air is now filthier than ever.

The Beijing Olympics

Five-ring circus

Jul 17th 2008
From The Economist print edition

A weekly round-up of news from the Forbidden Citius, Altius, Fortius

The Chinese authorities are taking no chances: 100,000 troops, anti-aircraft missiles, checkpoints ringing the city. Beijing's Olympics, they say, are the most **threatened by terrorists** in history. Evidence for this is thin. China says it has arrested 82 "suspected terrorists" in the western region of Xinjiang for allegedly plotting to sabotage the games. On July 9th two terrorists were reportedly executed there. A day earlier police killed five people in a raid on a "holy-war training group" in the region's capital, Urumqi. The suspects "wielded knives", a police spokesman said. Not exactly dirty bombs, but you have to start somewhere.

What worries Chinese officials is the risk of yet more **political embarrassment** after a round-the-world tour of the Olympic torch was dogged by protests. Even slogans on T-shirts make them fret. Spectators at the games have been banned from wearing "I love China" T-shirts (lest, presumably, anyone thinks they can get away with "I love Tibet"). Under pressure from foreign television networks, the government has reversed its ban on live broadcasts by the foreign media from Tiananmen Square, the city's most sensitive site. But it is insisting on limited hours and no invited guests—ie, no dissidents.

Officials say that, notwithstanding **Beijing's semi-permanent shroud of haze**, air quality is improving and should get even better. For two months, beginning on July 20th, drivers will only be able to use their vehicles on alternate days depending on their licence-plate numbers. The city plans this month to open two new underground-railway lines and a rail link to the airport, which could help reduce car traffic further. The worst-polluting factories in Beijing and its environs are being ordered to cut production or stop work altogether.

But who is to say if the air will be good enough for endurance events such as the marathon? An environmental official was quoted in the Hong Kong press, claiming **air pollution had been exaggerated**: "We don't need any independent party to help us monitor our air quality during the event." Unconvinced, some Olympic teams are staying away from Beijing until the last minute.

Doggone!

"If visitors ask for it to be served, we will dissuade them." *Xiong Yumei, deputy director of the Beijing Tourism Bureau, referring to the city's ban on Olympic-designated restaurants serving dog-meat, a common dish. Other restaurants can keep dog on the menu if they insist, but have been advised to drop it.*



WORLD
ASIA

Afghanistan

Dawn raid

Jul 17th 2008 | KABUL
From The Economist print edition

The Taliban show they are not just suicide-bombers

IT IS a tough, complex and until this week largely forgotten war that American troops fight in the high valleys of Kunar and Nuristan. The region is almost too high for helicopters to reach; there are few roads and dense pine forests provide ideal cover for insurgents, with short supply lines to safe havens across the Pakistan border. The advantages of Western technology and firepower are largely nullified.



They did not save the small American combat outpost at the village of Wanat in the Weygal valley. Two days after it was built, just after the 4.15am call to prayer on July 13th, intense gunfire streaked into the base from the village. Insurgents breached the defences. In fierce fighting, nine American soldiers were killed, more than in any single battle since 2005. Another 15 Americans and four Afghans were injured, out of a garrison of 45 Americans and 25 Afghans. The attackers were beaten back, and reportedly also took heavy casualties. But the "temporary" outpost has since been abandoned to the Taliban.

Such tiny combat outposts are an innovation of the past couple of years. They are designed to put American troops—sometimes just a few dozen—among the populace, usually alongside Afghan forces. The aim is to extend American influence outward from larger bases, which can provide artillery support. However, they are vulnerable to surprise attacks. At Wanat the defences had barely been finished, and the insurgents brought in several hundred fighters—a rogues' gallery, say local officials, of Taliban, al-Qaeda and others.

Nuristani officials say that the populace in Weygal has sided with the Taliban since a spate of recent bombing raids killed civilians. On July 4th a bomb attack in the area allegedly killed 17 civilians, including several Afghan medical staff. Two days later another raid hit a party on its way to a wedding in Nangahar province, killing 47 guests including the bride.

American commanders had been confident that they were getting the eastern border region under control. But there has been a spike in militant activity since a Pakistani government ceasefire with the Taliban in April. A 40% increase in insurgent attacks in the first half of this year compared with 2007 has been met largely through greater use of air power. American aircraft have dropped 40% more bombs—646 bombs and missiles were used in June alone. Inevitably, civilian casualties have also increased.

A delegation of 150 tribal elders from the Weygal area camped out in Kabul for several weeks waiting to make a formal protest to the Afghan president, Hamid Karzai. According to a local member of parliament, they left in disgust when the meeting was repeatedly postponed. The base was attacked two days later.

South Korea

Change of heart

Jul 17th 2008 | SEOUL
From The Economist print edition

A newly humble and emollient president, up to a point

EPA



WITH his once-hopeful presidency paralysed by weeks of street protests against imports of American beef, Lee Myung-bak (pictured) is now trying to restore a modicum of sanity to domestic politics and—in case that idea sounds insufficiently implausible—even to his country's dealings with North Korea.

A new, humbler Mr Lee, once admired as the "Bulldozer", is on display. His people last month renegotiated a beef deal with the United States, which had said that unless South Korea opened its market completely to American beef, then Congress would not approve a sweeping free-trade pact. Protesters had decried the risks of mad-cow disease, so the new deal limits imports to low-risk animals under 30 months old. That cuts little ice with many emotional protesters but—after Mr Lee last week also sacked three cabinet ministers over the fiasco—was good enough for the opposition Democratic Party to end its boycott of the National Assembly. The assembly convened on July 10th, after a six-week delay, with a backlog of work.

The following day Mr Lee spoke to the assembly, begging its help in tackling inflation and passing a raft of pro-business measures, tax cuts and pension reforms. He called for an end to labour disputes, and he promised help to families on low incomes. He also pressed the National Assembly to ratify the free-trade deal.

Mr Lee's newly professed humility represented perhaps less of a turnaround than his olive branch to North Korea. Just half an hour before his assembly speech, news came through that a South Korean tourist had been shot dead by a North Korean soldier. The 53-year-old woman, who was taking an early-morning stroll on the beach near North Korea's Mount Kumgang resort, might have been Mr Lee's excuse to underscore his earlier hardline policy towards the repulsive regime. But the North's recent declaration (albeit incomplete, see article) of its nuclear programmes, along with pressure at home, has forced a rethink. He called for a resumption of dialogue. Humanitarian aid, he said, should be renewed without precondition. Relations between the Koreas should "transcend changeovers in administration". Clearly, Mr Lee now fears that without a change of heart, South Korea might stand on the sidelines as North Korea and America negotiate a normalisation of ties.

This week the parliamentary floor leader of the ruling Grand National Party echoed the president's sentiments. Hong Joon-pyo said that the shooting "paradoxically" showed why North-South reconciliation was necessary. The reaction from the North has been less surprising. Kim Jong Il's regime called the appeal for talks "an intolerable insult". Far from showing any hint of contrition, it insisted that an apology should come from the South for halting tourist visits to Mount Kumgang.

Challenges have mounted on other fronts. On July 14th Japan announced new, more nationalistic guidelines for school textbooks about how to deal with the matter of the Dokdo islands (Takeshima in Japanese), a pathetic parcel of rocks which have been Korean-controlled since the second world war but which Japan claims it incorporated in 1905—po-facedly glossing over the small matter of forcing Korea to become a protectorate that year too. Neither Mr Lee nor Japan's prime minister, Yasuo Fukuda, want to make a big fuss of the textbook nonsense, but neither can be seen to look soft. South Korea's ambassador to Japan has been recalled; protests at Japan's embassy in Seoul continue; South Korea has rebuffed an offer of talks.

Disarming North Korea

Dance of the seven nuclear veils

Jul 17th 2008
From The Economist print edition

Only six-and-a-half to go

WILL North Korea ever reliably give up its pursuit of nuclear weapons? Few among the diplomats from America, South Korea, Japan, China and Russia most closely involved in a five-year, six-party effort to denuclearise the Korean peninsula would wager on it. But on July 13th China announced their agreement to take this dogged disarmament effort another step forward.

By October North Korea promises to have fully disabled its plutonium-producing 5MW nuclear reactor at Yongbyon. Work is under way to remove spent fuel-rods from the reactor; the cooling tower was blown up last month. Once its control rod is cut, it would take a year and a lot of effort and expense to restart the reactor. Some fresh fuel-rods for Yongbyon also have to be disposed of. South Korea has also offered to buy a stash of fresh fuel prepared for a now abandoned 50MW reactor; if talks broke down again as often in the past, North Korea could retool this for Yongbyon.

In the meantime it will allow inspectors from America and other countries to verify that its declaration last month of its production of bomb-usable plutonium is correct. A detailed protocol has yet to be hammered out. Inspectors will need a close look at Yongbyon's reactor core and nearby nuclear-waste sites, and access to officials and documents—all hitherto off-limits. In return, Kim Jong Il will receive the balance of the 1m tons of heavy fuel-oil, or its equivalent, promised in a six-party deal that was struck in February last year. America has started the process of taking North Korea off its list of state sponsors of terrorism and is lifting some trade sanctions.

But everyone knows Mr Kim's nuclear declaration was incomplete. Efforts to acquire machinery for enriching uranium (another possible route to a bomb) and help allegedly given to Syria to build a Yongbyon clone, destroyed last September by Israeli jets, are covered only in a confidential minute with America. But in that North Korea is likely to have admitted nothing.

Even the verification of the plutonium declaration will do little more than confirm North Korea's boast to be a nuclear power: it tested a nuclear device in 2006. Though the test was reportedly only partially successful, Mr Kim is thought to have enough plutonium for between six and ten bombs. Would he give it up? If at all, he would likely demand two things in return: a peace deal with America and new Western-designed nuclear reactors. The first, America says, will come only after denuclearisation. Would anyone want to trust Mr Kim with the second?

Indonesian Papua

More religions, more trouble

Jul 17th 2008 | JAKARTA
From The Economist print edition

Radical Muslim and Christian groups stoke the embers of Papua's conflict

THE separatist conflict in Indonesia's Papua region—formerly known as Irian Jaya and once one of the world's great liberal causes—has become relatively quiet in recent years. Small groups of protesters still occasionally gather to wave the Morning Star independence flag and get arrested for it. But decades of repression by the Indonesian security forces, combined with the granting in 2000 of partial autonomy from Jakarta, have sapped the separatists' ranks. However, according to a recent report on the region, there is a risk that the separatist conflict may be rekindled or replaced by religious strife because of the arrival of new and more muscular forms of both Islam and Christianity.



Broadly speaking, indigenous Papuans—who are dark-skinned Melanesians, like their kin next door in Papua New Guinea and Australian aborigines—tend to be Christians or animists, whereas the many migrants to the region from elsewhere in Indonesia are mostly Muslim. In recent years fundamentalist Christian groups, some started by American and Canadian preachers, have been proselytising among indigenous Papuans. Their success has also prompted the development of fundamentalist streams in the established Protestant churches.

Among the Islamic radical groups to arrive in Papua with the migrants is the Indonesian chapter of Hizb-ut-Tahrir, an organisation started in Jerusalem, which seeks to unite Muslims worldwide under one government or "caliphate". But there are also a few indigenous Papuan Muslims, some of whom have recently returned from studies in the Middle East, bringing back fundamentalist ideas.

The report, by the International Crisis Group (ICG), a think-tank, says rising religious tension has already come close to triggering violence between Muslims and Christians, as is already common in the nearby, mixed-faith province of Maluku. In Kaimana district, for example, members of the two religions had long lived together harmoniously. But in December locals came close to blows over the erection of an iron tower shaped like a Christmas tree, topped with a Star of David—often used by charismatic Christian groups but best known as a symbol of Judaism.

The new Christian groups have raised Muslims' hackles by boasting (sometimes falsely) of their conversions of Muslims. Muslims, in turn, have become increasingly vigilant against any perceived threats either to their faith or to Indonesian sovereignty. Some Islamic radicals are prone to conspiracy theories about plots to prise Papua away from Indonesia, often involving America and its majority-Christian regional allies, Australia and the Philippines.

Increased fundamentalism has sharpened each ethnic group's fear of domination by the other. The Indonesian government has discontinued its programme of transportation to Papua and elsewhere to relieve overcrowding on Java. But migrants are still flooding in. Official figures show that in 2004 Muslims

were 23% of the region's 2m-odd population, up from 6.5% in 1964. In reality the proportion of Muslims is thought to be much higher, probably over half now—but the government has not published accurate updated figures.

Christians believe this is a cover-up to hide the truth: that migration has made Papuans a minority in their homeland. They also fear that the government in Jakarta is increasingly endorsing Islamic orthodoxy at the expense of Indonesia's non-Muslims. The Muslims, in turn, agree that they are now the majority in Papua—a local Hizb-ut-Tahrir leader recently claimed that Papua is 65% Muslim—but they feel that Papuan autonomy could lead to them being discriminated against or even expelled from the region.

There are some moderating influences: last year, mainstream Muslims set up a new body, the Papuan Muslim Council, to put the case for tolerance. Some of the charismatic Christian groups, far from inciting separatism among ethnic Papuans, argue for accommodation with the Indonesian powers-that-be (render unto Caesar and all that). Even so, argues the ICG, there is a danger that continuing migration, combined with the radicalisation of both main religions, could re-ignite the dormant separatist conflict.

If the heightened religious tension is not to become a catalyst for violence it would help if there was a sense of urgency about improving the dismal quality of life of almost all Papuans, whether indigenous or migrants. Autonomy has had a feeble start: central-government ministries have been reluctant to cede control to local Papuan authorities; where they have, money has been misspent, including by newly recruited Papuan bureaucrats struggling with responsibilities for which they lack skills. Last year President Susilo Bambang Yudhoyono ordered his officials to speed up development programmes for Papua. As usual, his orders fell on deaf ears.

Economist.com WORLD ASIA

Singapore

Raising the bar

Jul 17th 2008
From The Economist print edition

A rare slip-up in court by Singapore's elder statesman, Lee Kuan Yew

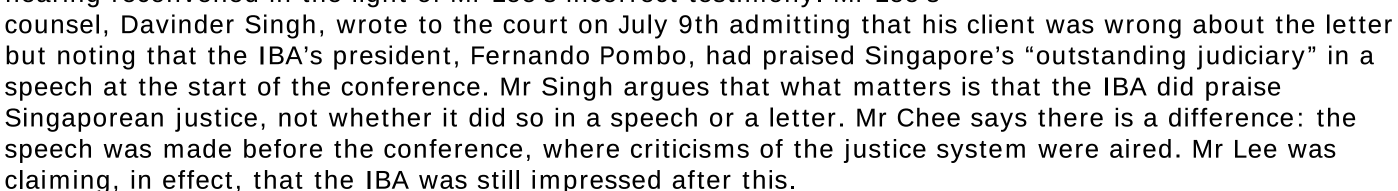
AP



MEMBERS of Singapore's government are notorious sticklers for legal exactitude. So it has been interesting to watch the reaction after the country's elder statesman, Lee Kuan Yew—a British-trained lawyer before he became a politician—gave inaccurate testimony in the trial of two opposition leaders.

In May Mr Lee testified in a hearing to decide damages against Chee Soon Juan, the leader of the Singapore Democratic Party (SDP), and his sister, Chee Siok Chin, for defaming the former prime minister and his son, Lee Hsien Loong, who is now prime minister himself. Mr Lee senior claimed that after the London-based International Bar Association (IBA) held its annual conference in Singapore last October, its president sent a letter to the Law Society of Singapore praising the country's justice system. It has since emerged that there was no such laudatory letter.

Mr Chee (who along with his sister was briefly jailed for contempt for accusing the judge in his case of bias) tried unsuccessfully to have the hearing reconvened in the light of Mr Lee's incorrect testimony. Mr Lee's counsel, Davinder Singh, wrote to the court on July 9th admitting that his client was wrong about the letter but noting that the IBA's president, Fernando Pombo, had praised Singapore's "outstanding judiciary" in a speech at the start of the conference. Mr Singh argues that what matters is that the IBA did praise Singaporean justice, not whether it did so in a speech or a letter. Mr Chee says there is a difference: the speech was made before the conference, where criticisms of the justice system were aired. Mr Lee was claiming, in effect, that the IBA was still impressed after this.



By coincidence, on July 9th the IBA's Human Rights Institute issued a report criticising the use of defamation suits by the ruling People's Action Party (PAP) to silence the opposition and the press, and expressing concerns about the independence and impartiality of Singapore's judges. The law ministry has rejected the IBA's report, pointing out that Singapore's legal system has won excellent ratings in other international surveys. Indeed, in cases not involving the country's leaders, there is no dispute about its quality. As for the IBA's worries about cases involving PAP figures, the law ministry claims that the IBA failed to substantiate its "grave" allegations with evidence, though its report does discuss several worrying cases.

America's State Department, which is in rather less danger of being sued by the PAP than are the opposition or newspapers, has expressed concern about judicial independence in political cases in Singapore. In its latest human-rights report, in March, the department noted that the PAP's consistent success in defamation suits against critics "led to a perception that the judiciary reflected the views of the ruling party in politically sensitive cases."

According to the *Straits Times* newspaper, Mr Lee on July 11th accused human-rights organisations of "a conspiracy to do us in". He said that they saw that Russia and China had been studying Singapore's success, and hence regarded it as a threat. Mr Lee and the government argue that doing things their way has made Singapore prosperous, orderly and corruption-free, and has earned international respect. The threat of defamation proceedings may make opposition politicians weigh their words more carefully than they do elsewhere. But Singaporean voters continue to buy the PAP's argument that such constraints are a price worth paying—so far.

Malaysia

The trials of Anwar

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From The Economist print edition

The opposition leader and another critic arrested

SO FAR, the case against Anwar Ibrahim, Malaysia's main opposition leader, has stayed pretty close to the script from 1998. Now, as then, he poses a threat to the prime minister of the day. Also as then, he faces accusations of "sodomy" (ie, homosexual sex, a crime in Malaysia) from an aide. And on July 16th, in another flashback to 1998, armed police in balaclavas pounced on Mr Anwar and took him for questioning.

Last time Mr Anwar was beaten during interrogation and appeared in court with a black eye. He was jailed for 15 years but freed in 2004 after the appeal court overturned his conviction. This time Mr Anwar, who had briefly sought refuge in the Turkish embassy when the accusations surfaced, was released on bail after one night in custody. No charges have yet been filed. The prime minister, Abdullah Badawi, promised there would be no repeat of the "black-eye incident".

Mr Badawi is fighting for survival after his coalition's poor showing against the opposition in elections in March. He promises to hand over to his deputy, Najib Razak, in 2010—but he may not last that long. Before the latest sodomy allegation, Mr Anwar claimed he was close to getting enough defections from the government benches to achieve a parliamentary majority. He says the accusations are a plot to stop him taking power and prevent him from presenting new evidence that Malaysia's current police chief and attorney-general helped fabricate evidence against him in 1998. Then, the accusations against Mr Anwar surfaced after he was sacked as deputy to the then prime minister, Mahathir Mohamad, and made claims of corruption in the government. Evidence has recently emerged that seems to support Mr Anwar's claims of political interference in the judiciary, both under Mr Badawi and Dr Mahathir.

Embarrassingly for the government, the opposition has produced photographs of Mr Anwar's accuser, Saiful Bukhari Azlan, meeting various government ministers, lending weight to the claim that it is all a political plot. Mr Najib has admitted to meeting Mr Saiful shortly before he went to the police with his accusation, but denies being behind the allegations.

The day after Mr Anwar's arrest another thorn in the government's side was arrested. Raja Petra Kamarudin, an anti-government blogger and a member of one of Malaysia's royal families, was charged with criminal defamation after accusing Mr Najib and his wife of involvement in the grisly murder of a Mongolian woman, for which one of Mr Najib's advisers is at present on trial for abetting a murder. Earlier this month a private investigator hired by the adviser filed an affidavit making further lurid claims about Mr Najib and the Mongolian, only to retract it a day later, claiming he had made it under duress. He then vanished. Again, Mr Najib vehemently denies all the accusations.

Mr Anwar's trial in 1998 became an international media circus which sullied the reputation of a country hitherto seen as a modern, dynamic Asian tiger. A repeat now seems likely: America's State Department said after his arrest that it raised "serious questions and concerns". But with the spread of the internet, the government this time has far less control over what Malaysians get to hear through their local news media. If it hopes to destroy Mr Anwar by slinging mud at him in public, it may end up looking rather dirty itself.

The International Criminal Court

Sudan’s leader is accused, but others can expect to follow

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Illustration by Peter Schrank



Will the indictment of Sudan’s president for alleged war crimes help or hinder the prospects for peace in Darfur?

ONCE again, the battle between peace and international justice has been joined. On one side are those who predict that this week’s decision by Luis Moreno-Ocampo, chief prosecutor of the International Criminal Court (ICC), to seek to indict Sudan’s president, Omar al-Bashir, for genocide will bring even more bloodshed and suffering to Darfur, his country’s ravaged western region. On the other are those who say that giving in to Mr Bashir’s blackmail—by withholding an indictment in the hope that he will co-operate with UN and other peacekeepers—will undermine the fledgling court’s credibility and encourage other murderous tyrants.

It is the first time that the court has gone after a sitting head of state. Serbia’s Slobodan Milosevic and Liberia’s Charles Taylor were both presidents when first charged with war crimes, but they were brought to book by other international tribunals. It is also the first time the court has sought an indictment for genocide, the gravest of all international crimes. Until now, only the United States had attached that label, with its implied obligation of international intervention, to what has been going on in Darfur for the past five years.

Mr Moreno-Ocampo has not taken this step lightly. For months he has been dropping hints about what he might do if Mr Bashir failed to stop the atrocities being carried out by Sudanese forces and the government-backed *janjaweed* militia, and if he continued to refuse to hand over to the court the two men indicted over a year ago for war crimes in Darfur: his own minister for humanitarian affairs, Ahmad Harun, and Ali Kushayb, a *janjaweed* leader.

But the killing, raping, bombing of schools, torching of villages and attacks on peacekeepers and aid workers have all continued with equal ferocity. Far from co-operating with the court, as he is obliged to do under a UN Security Council resolution in 2005 that referred Darfur to the ICC for investigation, Mr Bashir has deliberately cocked a snook at it—and at the Security Council—by promoting Mr Harun and freeing Mr Kushayb from jail in Khartoum, Sudan’s capital, claiming he had no case to answer. The chief prosecutor’s allegations of Sudanese government responsibility for the atrocities was “the mother of all fabrications”, Sudan’s ambassador to the UN proclaimed in December.

Mr Moreno-Ocampo had hoped that his very public hints that his sights were set on Mr Bashir might persuade him to co-operate. The prosecutor’s equally public application now to the ICC’s pretrial chamber for an arrest warrant for the Sudanese president—he could have quietly applied for a sealed warrant, as he has done before—was made with the same intent. The court’s judges usually take two or three

months to decide whether the evidence presented to them is sufficient to bring charges. If, as seems unlikely, Mr Bashir suddenly decides to mend his ways in Darfur, the prosecutor may be persuaded to withdraw his request.

The court, set up under a Rome treaty in 1998, is totally independent, as are its judges, who hail from a variety of countries. The prosecutor's position is a bit different. Mr Moreno-Ocampo, an Argentine, says it is not for him to consider the implications of his acts; that is for the politicians. He merely follows wherever the evidence leads him. Nevertheless, he is a wily operator, with long experience in handling sensitive political cases. In the mid-1980s, he helped prosecute nine former leaders of Argentina's military junta, including three former heads of state—the first prosecution of senior commanders for mass crimes against civilians since the trials of German Nazi leaders in Nuremberg after the second world war.

Unlike most of the other one-off international tribunals, such as the ones that judged Liberia's Mr Taylor and some of the perpetrators of genocide in Rwanda, the world's first permanent international criminal court is not directly beholden to the UN. Those negotiating its charter, including the five permanent members of the UN Security Council, nevertheless inserted a clause to allow a political judgment to be made, in certain particularly sensitive cases, on where the balance should lie between the interests of peace and stability on the one hand and justice on the other. So the Security Council was given the power, under Article 16 of the ICC's charter, to suspend for a period of 12 months, with indefinite renewal, any investigation or prosecution.

Many, fearing a fierce backlash from Mr Bashir's indictment, are now urging it to do so. Some 300,000 Darfuris may have died and several million were forced to flee their homes as a result of the violence in the past five years. That carnage and upheaval could get far worse, they say, dashing any hope of peace. Peacekeepers and aid workers, already under attack, could be thrown out, threatening the lives of the millions who depend on them for food, health and relative security. The separate fragile peace between the north and south of Sudan could be broken too. Was this a risk worth taking?

More bark than bite from Bashir, so far

The noises from Khartoum have been relatively subdued. The court has been insulted, its decisions denigrated as “politicised”, the charges of atrocities in Darfur denied. Some street demonstrations have been orchestrated in Mr Bashir's support. Otherwise the government has expressed its “dismay” over the president's threatened indictment, and has called on the Security Council to suspend its proceedings.

Will it? This is an unprecedented situation for the Security Council; it has never had to consider invoking its powers under Article 16 before. While its five permanent members (Britain, China, France, Russia and America) say they are not ruling out any option, they seem to want to wait to see where Mr Bashir will jump before taking a decision. Any action before the ICC decides whether to indict Mr Bashir is unlikely. The five hope the increased pressure on him may persuade him to change course. Britain and France, the only members of the permanent five who have signed up to the ICC, are anxious not to do anything to damage its credibility. Suspending its first case against a serving head of state could do so.

In setting up the ICC, which this week celebrates its tenth anniversary, its founders had two main aims: to end impunity for the worst mass crimes and to deter would-be perpetrators. In the five years since the court began operating, it has indicted 12 suspects, four of whom are now in prison in The Hague, and is about to start its first trial. Given that its first four cases are all in Africa, some have accused the court of bias. But in the case of Congo, Uganda and the Central African Republic, it was their governments that requested the court to investigate; no others have done so. As for Sudan, it was the UN Security Council that asked the court to intervene—again, the only time it has done so. So the court cannot be held responsible.

For a court without any physical means of enforcement, arresting mass-criminals is extremely difficult, especially since many signatory states—now up to 107 after this week's ratification of the Rome treaty by Surinam—are loth to help. But building up a deterrent is even trickier and takes longer. To have credibility, the court must be consistent. Mr Moreno-Ocampo reckons he cannot afford to give in to threats from big shots.



Iran and America

A surprising move

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Why America is sending a top man to talk directly to the Iranians

WHEN William Burns, a top American diplomat, sits down with five colleagues from Britain, China, France, Germany and Russia in Geneva and the EU's Javier Solana on July 19th to hear Iran's response to their latest offer of talks to end its nuclear defiance, it will be a double first. The first time America has fielded so senior an official for direct talks with Iran on nuclear matters (though lower-ranking ones have talked about Iraq, and America is musing about sending a couple of diplomats back to Tehran after an absence of 30 years). And the first time Iran has not simply backed away at such a revolutionary prospect.

Whether it will lead on to what America and the other five hope—a six-week freeze on further expansion of Iran's uranium-enrichment effort and on further UN sanctions, followed by enrichment suspension and negotiations on a clutch of incentives to end the work altogether—is anyone's guess. Iran's fiery president, Mahmoud Ahmadinejad, says that the uranium work will go on. So long as America understands that, he says, talks can go ahead on an "equal footing".

So why is Mr Burns showing up at all? His boss, Condoleezza Rice, the secretary of state, has offered direct talks with Iran any time, anywhere. Her boss, George Bush, still says Iran must first suspend its uranium and plutonium activity as the UN has demanded. Iran claims to have no other nuclear purpose than to fuel reactors to make electricity. Others suspect the real aim is to acquire enough fissile material to build a bomb.

Mr Bush has six months left to end the world's most dangerous nuclear conundrum. Iran is under pressure too. Its multiple rocket tests this month were no doubt in part a response to reports that Israel's fighter-bombers had rehearsed mid-air refuelling for long-distance action. Meanwhile the latest offer from the six for expanded political, trade and security ties, as well as help with advanced but less dangerous nuclear technologies, may have stirred debate in Iran: some officials have signalled a readiness to explore possibilities; others still balk.

Iran had been hoping that international inspectors would by now have closed the book on its nuclear activities, but new intelligence about past weapons-related work has sharpened their questions. It may still be tempted to drag its feet and see what the next American president will do. Having Mr Burns in Geneva, it is hoped, will underline the seriousness of the offer to negotiate, but also Iran's need to choose.

Zimbabwe

A worthless currency

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From The Economist print edition

The local dollar is fast shrivelling away

EPA



The tragi-comedy continues

WITH prices doubling every few days, Zimbabweans now spend huge amounts of time and energy preventing their meagre cash resources from completely evaporating. Trying to catch up with galloping hyperinflation, now officially running at 2.2m per cent a year and at least four times faster in reality, the central bank has been printing ever bigger denominations. But it is outrun by galloping prices: at last count, the most valuable banknote available was for 50 billion Zimbabwean dollars, now worth barely 70 American cents on the black market, and the stock of Zimbabwean dollars is dwindling. Local cash could become scarcer still, now that the German company that was providing Zimbabwe with paper to print its banknotes has cancelled its contract; the Zimbabwean monetary authorities are likely to turn to a less specialised supplier. Meanwhile, people do not even bother to pick up notes of hundreds of thousands on the pavements of Harare, the capital. At independence in 1980, the Zimbabwe dollar was more valuable than the American greenback.

It may seem odd that the local currency is still used at all. From Z$25 billion to the American dollar at the beginning of this month, the cash exchange rate had jumped threefold within a fortnight. In restaurants or shops, prices are still quoted in local currency but revised several times a day. Salaries are paid in Zimbabwean dollars, still the only legal tender. A minibus driver taking commuters into Harare every day still charges his clients in Zimbabwe dollars—but at a higher price on the evening trip home—and changes his local notes into hard currency three times a day. The local money is losing its relevance.

Zimbabweans spend their local dollars as fast as possible or change them into hard currency on the black market. A parallel system is thriving in back offices and parking lots. Ronald was a civil servant but became a money dealer about a year ago to feed his family. He now makes about $100 a month, whereas his former colleagues earn the equivalent of less than $2 a month, enough to buy two loaves of bread. On a recent trip, this correspondent changed money from a central-bank employee running an illegal foreign-exchange business in his own office.

With a strict daily limit (currently less than $1.40) on bank withdrawals, people shun banks as much as possible and are returning to a cash economy. Petrol and rents are now charged mainly in American dollars or South African rand, but since some landlords have been taken to court, rents are increasingly often paid for in groceries. People buying overpriced cooking oil or sugar on the black market, since those items have long vanished from shops due to official price controls, are charged more if they pay in local dollars. Petrol coupons have become a virtual currency.

John Robertson, a local economist, reckons that the informal economy has probably become larger than the formal one. Though estimates are fuzzy, he believes that money sent by Zimbabweans abroad to friends and relatives at home, which used barely to register on Zimbabwe's foreign-exchange radar screen, now accounts for probably a third or so of the country's foreign-exchange inflows.

Turning to foreign exchange or barter is what you would expect in countries that have had inflation of more than a few hundred per cent a year. At the height of its inflation crisis, shops in Argentina were no longer able to price their goods. In some cases, Peruvians started using lavatory paper, then in short supply, as currency. But Zimbabwe holds the dubious distinction of being the only country in the world today that is suffering from hyperinflation: that is, prices are increasing by more than 50% a month. It has not yet reached Hungary's level after the second world war, when inflation peaked at 42 quadrillion per cent a month. But it could yet get there.

In May, the central bank decided to let the exchange rate, until then fixed at a grossly overvalued rate of Z$30,000 to the American greenback, float on the interbank market. For a short while, the rate settled at a level close to the black market's. But very few ordinary people can obtain foreign exchange from banks; most still use the black market to get rid of their Zimbabwean dollars. So the legal and parallel rates have again grown apart. People sending money or groceries to relatives in Zimbabwe still use informal channels.

Hyperinflation can usually be tamed within a few months, provided authorities stop spending money they do not have and no longer turn to printing presses to cover for it. But the damage lingers for years. Argentines held about 60% of their bank deposits in foreign exchange three years after the high inflation of the late 1980s was over, compared with less than 10% before the crisis. In Peru and Bolivia, over 80% of bank deposits were held in hard currency three years after the countries' inflation crises.

Reform will eventually come and prices will stabilise in Zimbabwe, especially if President Robert Mugabe is replaced; but the local dollar will never be the same. Some people have suggested that a reformed Zimbabwe should become part of the rand zone, but so far neither the South Africans nor Zimbabwe's battered opposition have sounded keen on the idea.

The Indian Ocean

The most dangerous seas in the world

Jul 17th 2008 | DAR ES SALAAM AND PORT VICTORIA
From The Economist print edition

Pirates are terrorising the high seas off Africa's east coast


Reuters



Get article background

ON A dazzling morning in April, the *Playa de Bakio*, a Spanish fishing boat, limped into paradisal Port Victoria in the Seychelles, damaged by grenades. Its crew of 26 was shaken. A Spanish military aircraft flew them to momentary fame in Spain. The fishermen had been held by Somali pirates for a week and freed after a ransom of $1.2m—so it was rumoured—was paid, in contravention of Spanish law.

The boat, a big industrial vessel known as a purse seiner, was easy prey. The pirates attacked on a speedboat launched from a mother ship, a captured Asian fishing ship known as a longliner. Once on board, they regaled the crew with tales of famine in their villages. Some of the Spaniards felt sorry for them. When one of the pirates stripped his shirt off, “he was all bones, no meat at all,” said a Basque crewman. The Spaniards were less enamoured of the pirates when they threatened them with machineguns and knives. “They valued life less than cockroaches,” said the skipper.

The boat was fishing for skipjack tuna—a staple for sandwiches—across the Indian Ocean. Critics suggested that it was too close to Somali waters, but the boat's log recorded it as 247 nautical miles (457km) off Somalia's shore when the pirates struck, well outside the official economic exclusion zone that extends 200 nautical miles. Spain banned its fishermen from entering Somali waters two years ago. The boat's insurance would have been void if it had done so.

Longliners, which are quite small, do fish illegally in Somali waters, especially in the months after October when monsoon winds draw tuna from across the Indian Ocean. Packed with ice, they try to catch a few tonnes of the more valuable sort of tuna, known as bigeye and yellowfin, while the bigger purse seiners like the *Playa de Bakio*, most of which are European, sweep up hundreds of tonnes of less valuable skipjack tuna outside Somalia's waters. Many cheating longliners are from Taiwan and Indonesia; others are from Sri Lanka, Thailand and elsewhere. With blurred markings, they transfer their catch at sea to bigger cargo ships or bribe officials to land their catch illegally in African ports. There may be a thousand or more of them in the Indian Ocean, unchecked and untraceable. Some buy licences from Somali warlords. A few arm their boats with anti-aircraft guns big enough to blow an approaching pirate skiff out of the water.

Jolly Roger, Somali-style

While these so-called “bio-pirates” strip Africa's waters of a valuable and sustainable resource, the more

conventional pirates terrorise one of the world's busiest shipping lanes. All ships heading south after passing through the Suez Canal must ply the waters between Somalia, a failed state, and Yemen, where civil strife has been increasing. This is now one of the world's most dangerous passages. The International Maritime Bureau advises ships to keep 200 nautical miles off Somalia. As the attack on the *Playa de Bakio* shows, that is not far away enough.

There were at least 50 recorded pirate attacks in it last year; some go unreported after ransoms have been paid. This year's tally is likely to be twice as high. In the past ten days, a Ukrainian and a German ship have been freed after paying ransoms to Somali pirates thought to be $800,000 and $750,000 respectively. Piracy is plainly spreading more widely across the Indian Ocean. Tanzania reported 14 attacks off its shores last year. Officials in the Comoro Islands say pirates are looking to use their country to attack tankers passing through the Mozambique Channel.

The costs of avoidance are high. Captain Twalib Khamis, harbour master of Mombasa, Kenya's (and east Africa's) busiest port, says that avoiding pirates adds two or three days' sailing for container ships passing through the Gulf of Aden to Mombasa. Higher insurance premiums push costs up even higher. There are knock-on effects too: most cruise ships, for instance, feel obliged to steer clear of east Africa altogether.



But the pirates' biggest victim has been Somalia itself. Some 2.6m of the country's 8m people depend on food aid that comes by sea. French, Danish and Dutch naval ships have escorted ships carrying food from Mombasa to Mogadishu, Somalia's capital, for the UN's World Food Programme, but it is a fragile supply line. In May, a Jordanian freighter, the *Victoria*, carrying sugar for displaced people, disappeared 56km (35 miles) off Mogadishu before being freed a week later. It is hard for the UN to find shipowners willing to take the risk without an armed escort.

After Somalia's collapse into civil war in 1991, some Somalis began to steal the odd small fishing boat. These days the pirates are a lot more sophisticated and better organised, with powerful speedboats, mother ships in the high seas, heavy weapons, satellite equipment, and negotiators abroad who handle ransoms. They target bigger ships at night, lighting up the sky with tracers, heavy-machinegun fire and rocket-propelled grenades.

Captured vessels are usually sailed into Somali waters until a ransom is paid. A Danish icebreaker, the *Svitzer Korsakov*, bound for Kamchatka in Russia's far east, recently spent six weeks off the Somali coast after pirates captured it; its crew was fed with goats ferried from the parched shore and slaughtered

aboard. The Ukrainian ship freed last week had been held for nearly seven weeks.

Blow them out of the water

In June a unanimously-backed UN Security Council resolution tabled by France and the United States made it legal for foreign navies to chase pirates into Somali waters and, if need be, sink them. But many Somalis are loth to co-operate. Their feeble government lacks the clout to tackle pirates in such places as Haradheere, in central Somalia, where many hail from. Somalis ask why the UN is so worried about the fate of foreigners at sea, while it does so little to help Somalis on land.

In any event, Somalia is not the pirates' sole base. They operate out of Yemen too. Pirates from both countries have teamed up with smuggling gangs based elsewhere in Africa who deal in ivory, rhino horn and diamonds from Africa's interior, says Christian Nelleman, a UN anti-poaching expert. The illicit goods pass through Somalia and on to Yemeni ports such as Mukalla and Balhaf, thence across Yemen's rugged Hadhramaut mountains and on by various routes to China.

So far foreign navies have had only occasional successes. Earlier this year a French yacht, *Le Ponant,* was seized by pirates with a crew of 30 while sailing from its winter waters in the Seychelles to the Mediterranean. France's president, Nicolas Sarkozy, ordered Djibouti-based French commandos into action. A ransom of $2m was paid. The pirates freed the yacht and dispersed. One group, speeding away through the Somali desert in a jeep, was tracked down by a French helicopter, shot up, and extradited to France to face trial.

Western intelligence services are less worried about the growing cost to global shipping than the possibility that the pirates may link up with, or turn into, Islamist terrorists. The Americans are paying *Lloyd's List*, a London-based shipping newspaper, for data on shipping movements in the area. They have captured Abd al-Rashim al-Nashiri, al-Qaeda's mastermind for attacks at sea, and are seeking the death penalty for him. He is accused of organising the attack on the *USS Cole* in Aden in 2000, when 17 American sailors were killed, and another on a French tanker, the *Limburg*, in 2002. Port security in Aden and Mombasa has been stepped up.

African governments have yet to realise that they will have to do more themselves. East Africa does not have a single warship in good shape. Tanzania's navy chief, Brigadier Said Omar, says that his fleet never reaches the high seas; its operational range is 20 nautical miles. When asked to describe his ships he laughs sadly. “Ships? We don't have ships. We have very old, very small boats.” Peter Kivuyo, Tanzania's police marine chief, says his force might reach five nautical miles offshore “if the waves are small”. His men do not even have binoculars. After President George Bush visited Tanzania earlier this year, some hints were dropped—so far to no avail—that some high-speed interceptor boats might come in handy.

Africa may have to look to South Africa, the continent's sole coastal country between the Red Sea and the Cape with a proper navy. Western governments seem reluctant to invest in anti-pirate measures. So far the pirates seem well ahead in an increasingly lethal and costly game.



WORLD
EUROPE

Italy's government

Berlusconi fiddles, Italy burns

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Silvio Berlusconi's government is turning out to be depressingly similar to his previous one

Illustration by Peter Schrank



THIS time, it was all meant to be different. Silvio Berlusconi exuded sober responsibility in his successful bid to be re-elected prime minister in April. Unsurprisingly, say his apologists. His government from 2001 to 2006 was a tale of missed opportunities to modernise Italy and leave his mark on history that he now regrets.

There were other reasons for hoping that he would govern the country for its own good, rather than for his. He was known to aspire to the presidency and so needed to acquire an aura of statesmanship. One reason his previous government failed was resistance to liberal reform by the Union of Christian and Centre Democrats, which is no longer part of his coalition. And he seemed to have solved his personal difficulties with a string of *ad personam* laws that secured his legal position and protected his business empire.

Yet ten weeks after the swearing-in of Mr Berlusconi's new government, the political agenda is dominated more than ever by his personal and corporate interests. In its short life, the government has put forward at least four *ad personam* measures.

One was intended to dodge a European Court of Justice ruling that Rete 4, one of three television channels in Mr Berlusconi's Mediaset network, was occupying frequencies that should go to another operator. The government proposed a decree to prevent Rete 4 being moved to satellite, but it ran into such fierce opposition that it withdrew the text for "reformulation".

A second decree was aimed at restricting telephone tapping in criminal investigations, and also the publication of transcripts. There are arguments for this change: a 2005 study by the Max Planck Institute found that eavesdropping was more common in Italy than in any other European Union country. Since the transcripts are often leaked to the media, even before charges are laid, innocent people can find their most private remarks splattered across the press.

But whenever Mr Berlusconi proposes any judicial reform, there are understandable suspicions of his personal motives (he recently called the judicial system a "cancer"). Before returning to office, he was taped on the orders of prosecutors in Naples as he lobbied an executive of Italy's public-broadcasting service, RAI, on behalf of some actresses. Since Mr Berlusconi undertook to back the executive in a private venture, both men were laying themselves open to accusations of corruption. Indeed, a judge is now mulling whether they should be indicted.

As the phone-tapping decree was being drawn up, rumours began of more compromising tapes, said to contain sexually explicit conversations between the prime minister and his 32-year-old equal-opportunities minister, Mara Carfagna, a former topless model and Mediaset presenter. After it was reported that prosecutors would destroy material irrelevant to their inquiry, the cabinet held back the decree, rousing suspicions that the purported conversations with Ms Carfagna lay behind it. Ms Carfagna has said she will sue over the allegations being made about her.

Critics say that Mr Berlusconi's legal problems are also central to two other measures. The first was drafted by the legal counsel who is defending him in court on charges of giving a $600,000 bribe to a British lawyer. Stuffed incongruously into a package of law-and-order changes, this law would have frozen for 12 months a range of trials, including Mr Berlusconi's. By then, a second bill was to take effect guaranteeing immunity from prosecution to Italy's four top office-holders, including the prime minister. Such was the outcry over the first measure that it was neutered by amendment, but only after it became clear that the second could be pushed through by the autumn, when Mr Berlusconi's bribery trial is due to end. The security package, approved by the Chamber of Deputies on July 15th, now contains what some opposition politicians say is a fifth *ad personam* measure, entitling defendants to plea-bargain in mid-trial.

The government's (and parliamentary) fixation with the courts and judicial reforms might be less alarming were there not so much else to be done that is both important and urgent. After a deceptive uptick in the first quarter, the economy is virtually stagnant again. Bank of Italy analysts paint a desolate picture of weak consumption and rising inflation. They have also raised the spectre of credit problems in a country that has so far been spared the worst of the global squeeze. They note that 70% of Italian mortgages are at variable rates, higher than the EU average—and this in a country where real disposable incomes are shrinking.

The central bank forecasts a paltry 0.4% growth in GDP this year and next. Its 2008 estimate is in line with the government's (between zero and 0.5%), but more optimistic than the IMF's April prediction of 0.3%. The Italian economy is yet again the backmarker in the euro area. Perhaps the most alarming news came on July 10th, when industrial production was reported to have slumped in May, down by 4.1% on a year earlier. Emma Marcegaglia, head of the employers' lobby, Confindustria, said she was "really worried". She is right. The engine of the good ship Italia is sputtering; the wind is blowing it towards the rocks; and the captain is busy with other matters.

So far the government's only economic initiatives have been to scrap an unpopular house levy and reduce the tax on overtime. There is no hint of any debate on the liberalising measures that Italy's hidebound economy badly needs. On the contrary, the government seems bent on pumping even more taxpayers' money into the crippled national airline, Alitalia, and is now talking of changing the law to permit this. Looking ahead to the autumn, Mr Berlusconi has at least announced one "radical reform"—but only of the courts.

Corruption in Italy

Home to roost

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Police investigators can touch centre-left politicians as well

TO SILVIO BERLUSCONI it was “strange”—and yet another reason for reforming the judiciary from its foundations. On July 14th police arrested Ottaviano Del Turco, the centre-left governor of the central Italian region of Abruzzo. Mr Del Turco served as finance minister in the 2000-01 cabinet of his fellow socialist, Giuliano Amato.

Mr Del Turco and various associates are accused of taking bribes on a gargantuan scale: €15m ($24m) from just one businessman, a private-health magnate, Vincenzo Angelini, who has chosen to co-operate with prosecutors. Mr Angelini says that he was told by Mr Del Turco that some of the money was needed to “buy” members of the Senate (the centre-left government’s majority in the upper house hung by a thread). Since the governor was put straight into solitary confinement, and not even allowed to see his lawyers, it is not yet clear how he intends to answer the charges.

Some of the details from Mr Angelini’s account would be comic were they not so serious. He says that he handed over bags full of notes at Mr Del Turco’s house “in a kind of store-room he had under the stairs”. The governor would give him apples to put in the bag so that anyone who saw him arrive would not notice that it was empty when he left.

Mr Angelini claims that when he complained about the sums he was handing over (including, he says, €6m to Mr Del Turco alone) he was threatened. He quotes another prominent regional leader of the centre-left as saying “either you pay or we won’t be able to hold back the [hospital] inspectors.” After deciding to collaborate with investigators, he carried a tape recorder to his meetings with the governor and had himself, complete with his bundles of cash, photographed by his driver.

The Del Turco affair is the most serious scandal to hit the left (as opposed to the right) for many years. But it may stretch further still. The governor’s predecessor, who once sat in the national parliament for Mr Berlusconi’s block, is also under investigation. After being questioned this week, he insisted that he was “stainless as a lily”.




Bosnia's future

Balkan end-games

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From The Economist print edition

The long and winding road towards the European Union



SARAJEVO has not looked this good since it hosted the winter Olympics in 1984. Most striking is the restoration of the Hotel Evropa, built in 1882 but left in ruins ever since it was gutted by Serb shells in 1992. Even gloomy Bosnians can see that Sarajevo has entered a new phase in its history. Most reconstruction after the 1992-95 war is over and many new buildings are going up, including one that is planned to be the tallest in the Balkans.

Times are changing in politics, too. A stabilisation agreement with the European Union has just come into force. It is a first step that should lead to eventual EU membership. The agreement, signed last month after Bosnia's politicians ended 18 months of political deadlock, marks what one weary diplomat calls "the end of the beginning". Bosnia won the deal only after its intransigent leaders wore down their EU partners into accepting a watered-down version of reform for Bosnia's police.

Miroslav Lajcak, the international pro-consul in Bosnia, argues that most of its 3.8m people now put jobs and prosperity above the old national questions. Yet they keep voting for nationalist parties. With local elections due in October, the country may now enter a fresh period of deadlock, as Serb, Croat and Bosniak (Muslim) leaders again champion the interests of their own people, not of the country as a whole. All the arguments that have dogged Bosnia since the Yugoslav collapse in 1991 could come to the fore again.

When the war ended in the 1995 Dayton agreement, Bosnia was divided into two entities, the Republika Srpska and the Bosniak-Croat federation. The first is dominated by Milorad Dodik, who often threatens a referendum on independence. The second is riven by divisions, not only between Bosniaks and Croats, but also among Bosniak leaders. One result is a budget crisis, as the federation has run out of money. The new EU deal should mean that Bosnian leaders can start on the reforms that are needed to move towards EU membership—though the Irish no to the Lisbon treaty has cast a cloud over all future EU enlargement.

In any case, Bosnians might be forgiven for thinking that the EU will bend to their will, not the other way around. In April Serbia, which had been told it could not have an EU stabilisation agreement until it co-operated fully with The Hague war-crimes tribunal, was suddenly given one as a bribe to get voters to back pro-European parties. The bribe worked: Serbia has just installed a pro-European government. But Bosnians concluded that, even when the EU sets tough conditions, political expediency will find a way round them.

In principle the reforms demanded by Brussels should strengthen Bosnia's weak state institutions. But this is not what Mr Dodik wants: he prefers the opposite. He can argue that there is a precedent. Even before the union of Serbia and Montenegro broke up in 2006, the two parts negotiated with the EU as separate entities, not as a single country. Alida Vracic, who runs Populari, a think-tank, believes that the key is to show Bosnians that there are real benefits from EU integration. “When we no longer need visas,” she says, “they will understand what this is all about.”



The Mediterranean Union

Sarko's southern dream

Jul 17th 2008 | PARIS
From The Economist print edition

It was a diplomatic success, but will the new Club Med go anywhere?

EVEN the buffet at this year's July 14th garden party at the Elysée had a Mediterranean theme. After a marathon weekend hosting 42 Mediterranean and European heads of state and government, President Nicolas Sarkozy looked as thrilled as he was exhausted. He had staged a grand summit to launch a Union for the Mediterranean, with a huge turnout, plenty of warm words and no big quarrels. To those doubtful of his ability to put his hyper-energy to constructive diplomatic purpose it was a useful corrective—but also a reminder of the limits of showman diplomacy.

The main achievement of the summit was to assemble such an improbable cast of leaders. Only Libya's Muammar Qaddafi boycotted the event on principle, arguing that it smacked of colonialism. Algeria's Abdelaziz Bouteflika threatened to stay away; but, after frenzied diplomacy, he turned up on the day. So did Turkey's Recep Tayyip Erdogan, who has been cool to Mr Sarkozy because of his opposition to Turkish membership of the European Union. Israel's Ehud Olmert and Syria's Bashar Assad even sat at the same table—although they did not actually meet.

Mr Sarkozy had been forced to strip his original vision for the Mediterranean Union of its grander purpose, after hostility from the Germans and others, who suspected it was a vehicle to promote French *gloire*. Bowing to pressure, Mr Sarkozy agreed to include all EU members, not just those with a Mediterranean littoral; to wrap it into an existing EU-Med scheme called the Barcelona Process; and to concentrate on practical matters, such as cleaning up the sea and developing solar energy.

Sure enough, leaders in Paris agreed to pursue these projects, and more. But Mr Sarkozy also returned, with evident delight, to his preferred theme. "Together we are going to build peace in the Mediterranean, just as yesterday we built peace in Europe," he declared, putting the quest for Middle East peace at the centre of the Club Med. Henri Guaino, an adviser who dreamt up the idea but was demonised in Brussels and Berlin for inept salesmanship, purred quietly in the corner.

As convoys of dark cars shuttled along roads closed to other traffic, most attention fell on the diplomacy. Mr Olmert met the Palestinian president, Mahmoud Abbas, and said that Israel and the Palestinians had "never been as close to the possibility of an agreement". Syria and Lebanon said they would open embassies in each other's capitals, which appears to imply recognition by Syria of Lebanon's sovereignty.

In inviting Syria, and then giving Mr Assad a front-row seat on Bastille Day, Mr Sarkozy was gambling that bringing him out of international isolation might yield some return over Lebanon, Israel or even Iran. This is an abrupt change in French policy. Jacques Chirac broke off ties with Syria after the assassination in 2005 of Rafik Hariri, a former Lebanese prime minister. Mr Chirac, who now lives in a Paris apartment belonging to the Hariri family, suspected that Syria was behind his friend's death and pushed for an international investigation that is still going on.

Mr Sarkozy, by contrast, believes that in foreign as in domestic policy you must deal with everybody, even the unsavoury. Through Turkish mediation, Israel has begun to talk to Syria. In Paris, where the Hariri case went unmentioned, Mr Assad told French television that he was ready to have "normal" relations with Israel—the two countries have been formally at war since 1948—but that direct talks would have to await a new American president.

It remains to be seen if anything much comes of all this. On Middle East peace, there were gestures and words, but no concessions. On the Union for the Mediterranean, there was no agreement on financing, nor even on where the club should be based. A performer, Mr Sarkozy is better at launching grand ideas than at following them up. Unpredictable, risky, abrasive, self-promoting and occasionally visionary, Mr Sarkozy's diplomatic style makes him an awkward partner. But after the Paris summit, even his detractors acknowledge that it succeeded this time.

France and Islam

A burqa barrier

Jul 17th 2008 | PARIS
From The Economist print edition

How Islamic headgear can stop a woman becoming French

WHAT is the right balance between public expressions of religious faith and legally enshrined national values? France, with its 6m Muslims and secular constitution, faces that question in acute form. In 2004 it banned the Muslim headscarf in state schools and other public buildings. Now the wearing of the burqa has been ruled “incompatible” with French values—and nationality.

A young Moroccan, Faiza M, married a French citizen in Morocco and came to live near Paris. In 2005 her application for French nationality was rejected for “lack of assimilation”. Now the Conseil d’Etat has rejected her appeal on the ground that she “adopted a radical practice of her religion, incompatible with the essential values of the French community, and particularly with the principle of sexual equality.” This is the first time the court has refused nationality on the grounds of religious expression. The court heard that the couple followed salafism, a radical form of Islam. The woman adopted the burqa at her husband’s request in France, where she “lives in total submission to the men in her family”.

The court decision has been welcomed. Fadela Amara, the cities minister, who is of Algerian origin, says the burqa is a prison. “It is not a religious sign but the visible sign of a totalitarian political project preaching sexual inequality,” she said. The new (Moroccan) head of the French Council for the Muslim Faith, Mohammed Moussaoui, called the burqa “neither an obligation nor even a recommendation” of Islam. In Britain and the Netherlands, the burqa has also stirred political controversy recently.

The paradox is that it was only when Faiza M came to France that she felt obliged to don the burqa. Ni Putes Ni Soumises, a group founded by Ms Amara to campaign for sexual equality, says many second-generation women in France come under pressure from Islamist radicals. Efforts to secure women-only sessions in local swimming pools and gyms are seen as similar attacks on equality. Last month a court in Lille caused a row by annulling a marriage between two Muslims because the bride falsely claimed to be a virgin, and the case was sent back for review. The latest court ruling may signal a more robust reaffirmation of secular values.

Poland's history

Solid no more

Jul 17th 2008 | WARSAW
From The Economist print edition

Poland's shipyards have been given a stay of execution. But will it help?

IT HAS not been much of a summer for Poland's heroes from anti-communist times. A book claimed that Lech Walesa, electrician, leader of the Solidarity trade union and Poland's first post-communist president, collaborated with the regime's secret services. On July 13th a car accident killed Bronislaw Geremek, who worked with Mr Walesa, was the brains behind Poland's peaceful transition to democracy and later served as foreign minister. Now the Gdansk shipyard that was the cradle of Solidarity risks going bust.

The pitiful state of the shipyards is not new. But a visibly irritated European Commission says the time has run out for the Polish government to privatise and restructure the two remaining state-owned yards. This week's decision to allow the Poles two months' grace to come up with a final plan has not altered Brussels's negative view of the yards' future. The commission's patience has worn "very thin", a spokesman said tetchily.

It seems eminently sensible to try to make the yards profitable again. But it is not easy after two decades of mismanagement and kow-towing to the unions, which have left the yards mired in debt and trapped between fixed-price long-term contracts and fast-rising prices for raw materials. Any suggestion of job losses meets instant union protests.

The other stumbling-block concerns state aid. The Gdansk shipyard, Mr Walesa's former employer, was sold last year to a Ukrainian steel company, ISD, that hopes to combine it with one of the other yards. Now the company is threatening to cut its losses and pull out, claiming that it was swizzled by the government over the risk of being ordered to repay illegal state aid. If the commission does not relax its competition rules to allow the aid, more than 3,000 jobs might be at risk, and a further 12,000 or so at the other yards.

One irony is that the world's shipbuilders are enjoying a boom as the global economy becomes ever more interlinked and trade grows. Even the shipbuilders in nearby Rostock, a former East German port that became notorious in the 1990s for unsavoury attacks by neo-Nazis on asylum seekers, are successful.

There is a chance that the present Polish government will be able to mop up the mess left by its predecessors. Successive governments have been eager to bask in the glory of the shipyards' role in the struggle against communism, but have shown little interest in trying to revive this troubled industry. If the government fails, Mr Geremek will no longer be around to witness the demise of the place where his dreams of freedom began.

Belgium's government

Leterme's limits

Jul 17th 2008 | BRUSSELS
From The Economist print edition

Another step in a low country's slow unravelling

BELGIAN government falls, not many hurt. That dismissive headline suggested itself on July 15th after Yves Leterme, Belgium's prime minister, tendered his resignation to the king because he had failed to resolve a bitter dispute about regional autonomy and minority language rights.

At mid-week Albert II had not accepted Mr Leterme's resignation. He was consulting leaders of Belgium's squabbling array of French- and Dutch-speaking political parties, as well as of the country's powerful regional governments. The king's hesitation was not due to any lack of practice: this was Mr Leterme's third resignation within a year (the first two times, he threw in the towel after failed attempts to put together a coalition government). The options now include asking Mr Leterme to stay on; calling an early election; or asking somebody else, such as Didier Reynders, the top French-speaker in Belgium's baggy left-right coalition, to have a go.

A successful provincial politician from Flanders, the Dutch-speaking north of Belgium, Mr Leterme has struggled on the national stage, held hostage by the conservative-nationalist alliance he created to win the election. His side's demands for more autonomy forced him into a confrontation with the French-speaking minority, who defend a strong central government as a guarantee of financial support for the south. To Flemings, this seems like obstruction by a self-serving minority.

Matters were further soured by a pledge by Mr Leterme to end linguistic concessions enjoyed by French-speakers living in parts of Flanders near Brussels. Brussels lies only a few kilometres inside Flanders, but jumpy francophones now mutter, only half-jokingly, about creating a "corridor" to link it to French-speaking Wallonia, as if preparing for Berlin-style encirclement. (One leader, Armand De Decker, has even suggested a route, running through a forest inhabited only by squirrels and the odd deer.)

Belgium's elder statesmen insist that those wanting to break up the country remain a minority, not least because nobody wants to lose Brussels. Most Belgians assume that the end-point of this crisis will, indeed, be another fudge that preserves Belgium as a country, albeit in a rather hollow shell. Alas, more than a year after the general election, it is clear that Belgium's ruling classes simply do not know how to get from here to there.

Charlemagne

Flying lessons

Jul 17th 2008
From The Economist print edition

The trouble that starts when low-carbon goals clash with low airfares

Illustration by Satoshi Kambayashi



IN EVER more secular Europe, something like piety suffuses the climate-change debate. Human acts that contribute to global warming are not just bad habits. To many Europeans, they are sins of carbon excess (and oil-addicted America looks like a greenhouse-gas glutton, dragging the planet to perdition).

In the couple of years since climate change forced its way to the top of the European Union's agenda, this hairshirt mood has kept things politically simple for policymakers. In 2007 EU leaders set ambitious targets for cutting greenhouse-gas emissions by 20% by 2020. Meeting those targets will be painful and expensive, but for now public opinion claims to be ready to drop bad habits. Almost eight in ten Europeans told a Eurobarometer poll last year that they thought they would need to change their energy consumption behaviour in the next decade.

But as the debate matures, the EU is starting to stumble on tougher choices, pitting the fight to slow climate change against European success stories and good new habits. A case in point is a big fight between Europe's airlines and politicians over plans to make airlines buy permits for emitting carbon dioxide after 2012 for all flights landing or taking off in the EU (enraged non-European carriers may yet block this, but that is another story).

Airline lobbyists and Eurocrats disagree about the effects of including aviation in the EU's emissions-trading scheme (ETS). Industry groups talk of carriers being forced to "buy" all of their future growth by making payments into the scheme. European Commission studies suggest that only a few points will be trimmed from growth that might otherwise see a doubling of emissions by 2020. But two things are clear even before a final deal is approved by ministers later this year. First is the need to control the growth in aircraft emissions so as not to negate all other efforts to create a low-carbon economy. But second, Europeans have developed a taste for flying that is often to be welcomed.

Cheap air travel has transformed Europe in ways that go far beyond the dreams of the founding fathers. For decades, European visitors to America marvelled at the way locals jumped on planes like buses. In contrast, most European routes were duopolies, with national capitals and the biggest cities connected by state-owned flag carriers. Fares might easily run to a week or more's salary for all but the richest jet-setters.

Then deregulation, starting in the 1990s, created a new low-fare industry almost from scratch. That has had marked socio-economic effects that chime with some of the EU's most cherished goals. Low-cost airlines have led the way in binding western Europe to new members from the old communist block. In

2000 there were just five scheduled routes between Britain and Poland. Six years later a study by the British air regulator, the Civil Aviation Authority, had identified 27 different routes, linking 12 Polish cities to 12 British ones. Britons are unusually fond of flying, it is true: among EU citizens, their propensity to jet abroad for holidays is beaten only by the Irish (inhabitants, like the British, of a wealthy island with a lot of dreadful weather).

But the rest of Europe is catching up: 1,000 new “city pairs” were added to European airline schedules between 2003 and 2007. And the new routes link regional cities, not just the national capitals. Low fares and multiplying routes have made it possible for a new band of highly mobile Europeans to work, live and weekend in different countries. British research shows a marked rise in business travel by lower-income passengers, as small, regional firms take advantage of low-cost fares to foray abroad in search of contracts, or skilled workers from the east commute to Britain and other countries for a few weeks at a time. That has also brought a surge in incoming passengers from places like Poland, flying in to visit friends and relatives.

Carbon for the weekend, anybody?

Critics of budget airlines still question the emissions caused by ownership of weekend cottages within two hours’ flying distance (property purchases linked to new air routes have redistributed billions of euros around Europe). They point to the frivolity of phenomena such as overseas stag weekends. Cheap flights—and whopping alcohol duties in Britain—have notoriously created a thriving business flying bridegrooms and their friends to cities from Bratislava to Riga, where they duly frighten the children and urinate in the Baroque fountains.

Peter Liese, a German Christian Democrat who shepherded the aviation-emissions law through the European Parliament, says that such policies as the zero tax on aviation fuel have distorted competition in favour of air travel. It is “not sustainable” for stag weekends by plane to be cheaper than in a bridegroom’s home town, he says. Lower-carbon alternatives to air travel should also be encouraged. For example, high-speed trains currently pay for carbon emissions through the electricity they consume, putting them at an unfair disadvantage to airlines.

But cheap air travel is still a success story for Europe, Mr Liese says, if the alternative is monopolies and prices far higher than they should be. British officials are even more cautious about rolling back the low-fares revolution. Adair Turner, a big cheese in business recently appointed to head a government carbon watchdog, noted on a recent visit to Brussels that flying was one area where Britons were least ready to cut back in order to help the environment. Lord Turner, who has been picked as chairman of the Financial Services Authority as well, suggested that other parts of the economy might have to take the strain instead.

A commission official admits that air travel presents a nasty dilemma: a “wonderful change” a decade ago that must now be reconsidered in a world of carbon constraint “before a general public understanding has set in.” The EU is only going to face more such dilemmas, as public opinion wakes up to the fact that climate change demands more than avoiding sins of excess.

The spectre of stagflation

Things can only get worse

Jul 17th 2008
From The Economist print edition

Illustration by David Simonds



As the economic pain intensifies there will be a political price to pay

FIVE years ago Mervyn King, the newly appointed governor of the Bank of England, gave warning that the "nice" decade would be followed by something less wholesome. Now starting his second term of office this month, Britain's leading central banker looks more prescient than ever. But even he surely did not expect that the "non-inflationary consistently expansionary" era would turn quite this sour.

As the film "Mamma Mia!" evokes nostalgia for the 1970s, more ominous echoes of that stagflationary decade are ringing louder and louder. The economy looks set to slip into a recession as the housing market slides and the banking trauma refuses to end. Yet at the same time inflation is rising inexorably higher. This toxic combination has been described as "stagflation-lite"; the "lite" seems ever less appropriate.

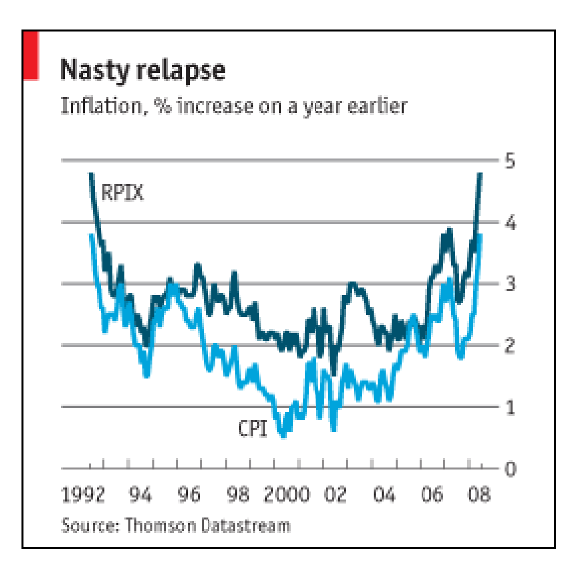
The scale of the oil-price shock now hitting the British economy is clearly similar to that of the 1970s. Indeed the prices paid by manufacturers for their fuel and materials soared by 30.3% in the year to June, the biggest jump since November 1974. This suggests that the prices those firms in turn charge retailers will rise even higher than the 10% annual increase in June, which was the highest rate of factory-gate inflation since early 1982.

Unless retailers absorb the cost increases coming down their supply chain by cutting their margins, this will bring more pain for already hard-pressed households. Consumer-price inflation is moving even farther away from the government's 2% target. In just two months, it has climbed almost a percentage point, from 3.0% in the year to April, to 3.3% in May and then 3.8% in June—the highest for 16 years.

As far as most shoppers are concerned, the consumer-prices index (CPI) is merely starting to catch up with their daily experience. The CPI may be used for the inflation target, but it commands little confidence because it excludes owner-occupier housing costs. The broader and longer-established retail-prices index (RPI) increased by 4.6% in the year to June. RPI inflation excluding mortgage interest payments—the measure used for the target from 1992 until the end of 2003—rose by 4.8%, also the highest for 16 years (see chart).

Whatever index is used tends to understate people's inflationary

alarm, which is coloured by the fact that the prices of everyday essentials are rising so fast. Road-fuel costs, for example, leapt by 24% in the year to June. Annual food-price inflation accelerated from 8.7% in May to 10.6% in June, according to the CPI; on the RPI measure, which stretches back much longer, it is a little lower (9.7%) but still the highest since 1982. Shoppers are keenly aware of these increases and pay little attention to the fact that less frequent purchases like cameras are getting much cheaper.



The labour market has remained one bright spot amid the enveloping gloom, but this is now clouding over. Figures based on the labour-force survey released on July 16th showed that employment continued to grow and that the jobless rate remained steady at 5.2%. Little comfort can be drawn from this, however, not least since the data extend only to May. The more timely figures for people claiming unemployment benefit showed a rise of 15,500 in June, the biggest monthly increase since 1992. Since then a number of homebuilders have announced big lay-offs. In the months ahead unemployment, which lags the economic cycle, looks set to rise, although this may be tempered by migrants returning to eastern Europe as jobs in Britain become scarce.

The return of stagflation has put the Bank of England in a bind. On the one hand, the fierce upsurge in inflation threatens to rekindle an inflationary mentality, in which both firms and workers expect prices to carry on rising rapidly. Although the annual growth of average earnings remains subdued, rising by only 3.8%, unions are flexing their muscles (see article). That calls for a pre-emptive rise in interest rates to show that the central bank means business about restoring price stability. On the other hand, a rapidly weakening economy should bring down inflation in due course. There is an increasing risk that the downturn could be severe, not least because of the fragility of Britain's mortgage lenders as the housing market subsides. That calls for lower interest rates.

Caught in this quandary, the central bank's rate-setters decided for the third consecutive month to keep interest rates on hold at 5.0% when they met on July 10th. They seem likely to maintain this do-nothing stance for some time. As long as inflation is accelerating, the monetary-policy committee will be loth to lower the base rate for fear that this may undermine the Bank of England's credibility.

What this suggests is that the economic malaise will stretch well into next year, and maybe into 2010. This should not come as a surprise. Banking and housing crises tend to drag economies down in their wake for several years. And if there was one lesson that policymakers learnt in the 1970s, it is that there is no easy cure for stagflation. After the nice years, a hard slog lies ahead.

That casts a long shadow over Gordon Brown's chances at the next election, which must be held by June 2010. Labour swept into office in 1997 with the catchy slogan "Things can only get better". During the "nice" years, that turned out to be the case. Voters rewarded economic success at the polls in 2001 and 2005. They are unlikely to forgive more recent failure when they next have the opportunity to pass judgment on Labour's record.

Trade-union militancy

Summer of discontent

Jul 17th 2008
From The Economist print edition

A new wave of strikes stirs memories of the 1970s

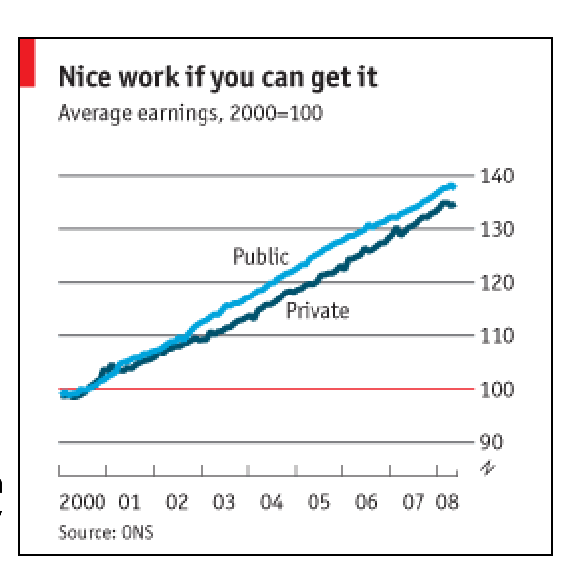
PA



Lobbying the House

FOR the schoolchildren, it was as if the summer holidays had come a few days early. For their parents, though, the strike by school-support staff—dinner ladies, teaching assistants and the like—as well as hundreds of thousands of other local-government workers on July 16th and 17th was less cause for celebration. Besides having to find babysitters or take the day off work, they also had to deal with unemptied bins and closed (or undermanned) town halls. For Labour ministers, it was a worrying portent of further confrontation with the unions that fund the party.

Council workers are unhappy with the 2.45% pay rise offered to them by town halls, arguing that, with retail-price inflation at 4.6%, the deal represents a wage cut in real terms. Both sides are appealing to public opinion. The trade unions say that many of the workers in question are poorly paid and often work part-time. The councils retort that any increases above 2.45% would require either higher taxes or cuts in public services.



Other government workers are feeling irritable, too. Over a thousand driving instructors downed their clipboards and sunglasses to coincide with the local-government strikes. Walkouts by Land Registry officials, immigration bureaucrats and coast guards are imminent. Health-service unions have mooted reopening pay talks if inflation stays high, and teachers' representatives are pondering strikes in the autumn. But rising prices affect all workers, and since average earnings in the private sector have risen less than in the public sector since 2000 sympathy may be in short supply (see chart).

On the same day as the strikes began, in a concession designed to mollify woes about rising prices, the government announced that a 2p increase in fuel duty planned for October was to be postponed until next spring. Ministers must walk a fine line: such concessions may curry favour with hard-pressed voters, but they also make Gordon Brown's beleaguered government look weak and indecisive. For now, the government has stuck to its pleas for pay restraint in both the public and private sectors, arguing that rising wages will only fuel the inflation that the unions are complaining about.

But that line may prove difficult to defend as inflation continues to surge. The trade unions are the Labour Party's traditional paymasters. Under Tony Blair, donations from business allowed the party to ignore

many of their demands, but its recent financial woes have strengthened the unions' hand. Labour's National Policy Forum is due to meet later this month to consider ideas that will end up in the election manifesto, and the barons have already begun to flex their muscles. Dave Prentis, the boss of Unison, a 1.4m-strong union representing many of the local-government workers on the picket lines, has accused Mr Brown of being “devoid of ideas”. He has also pointedly reminded the prime minister that his members are in the middle of reviewing the £1.5m they pay annually into Labour coffers.

The latest figures from the Electoral Commission, a watchdog, show that Labour has debts of £17.8m. On July 15th the party cancelled its spring conference in an effort to save money. With Labour's finances in such a mess, Mr Brown may for all his tough talk have to make some concessions to the unions, even if it evokes uncomfortable memories of the 1970s.

Assisted reproduction

No IVF please, we're British

Jul 17th 2008 | BOURN, CAMBRIDGESHIRE
From The Economist print edition

Test-tube babies are rare in the country where the first was born

Holdsworth Associates

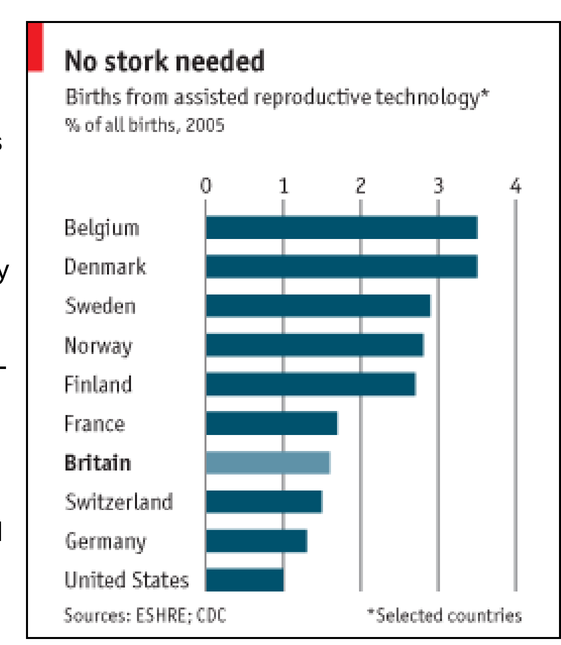


A special birthday party

"BABY of the century" ran the front-page headline of the *Daily Express* on July 11th, 1978. The paper promised the story of Lesley Brown, who was barricaded inside Oldham and District General Hospital, near Manchester, waiting to give birth. The world's press was camped outside; the front doors locked and staff forced to sneak in and out via a side entrance. Patrick Steptoe and Robert Edwards, the obstetrician and physiologist who had, nine months before, taken an egg from one of Mrs Brown's ovaries under anaesthetic and fertilised it in vitro with her husband's sperm, were in hiding. It had been, said *Time* magazine after Mrs Brown was delivered of a daughter on July 25th, "the most awaited birth in perhaps 2,000 years".

Thirty years after Louise Brown was born, "test-tube babies" are commonplace. Around the world 3.5m have been born and at least 200,000 more join them each year. Yet infertile people in the country where it all began are among the least likely in the rich world to receive what is now a standard treatment for their condition. Just under 700 attempts at in vitro fertilisation (IVF) are carried out per million Britons each year, one of the lowest rates in Europe. The 11,262 IVF babies born in Britain in 2005, the latest year for which figures are available, were just 1.6% of all births, compared with rates of 3-3.5% in the Nordic countries (see chart).

This is not because of restrictive regulation, as in Germany, where rules against storing embryos mean many couples seek treatment abroad. Nor is it because of lack of access to health care, as in America, where insurers often exclude fertility treatment and many young people have no insurance at all. It is because the National Health Service regards fertility treatment as a very low priority. As a result, it is strictly rationed. Only nine out of the 152 local primary-care trusts—the local bodies that control four-fifths of the health-care budget in England—pay for the recommended three attempts at IVF for every infertile couple that could benefit, and four of them pay for none at all. Of the 45,000 IVF treatments carried out in Britain in 2005, two-thirds were paid for privately.



The consequences were in evidence on July 12th at Bourn Hall, where 30 IVF "babies", one for each year of the technology, gathered to celebrate Louise Brown's birthday. The clinic in rural Cambridgeshire—the world's first dedicated to fertility treatment—was set up in 1980 by Dr Steptoe and Mr Edwards, after two years of searching for somewhere to continue their

work—and funding for it. “The NHS, medical charities, everyone turned them down,” explains Mike Macnamee, the clinic’s CEO. “Bourn Hall had to be established privately because the NHS wouldn’t pay for it.”

As the happy families mingle in the grounds, drinking champagne and taking pictures of their children with Louise Brown, they swap stories—of hope, bitter disappointment and eventual joy, but also of loans from grandparents, extended mortgages, and second and third jobs taken to pay for treatment. Geoff and Elaine Holt conceived their six-year-old son, Tim, at Bourn Hall on their third IVF attempt. Mr Holt is paralysed below the chest as a consequence of a diving accident 22 years ago. The couple spent all their savings and took out a loan to pay for private treatment after the NHS told them to “learn to live with childlessness”. “I’ve had my fair share of disappointments and being told what I could and couldn’t do,” he says. “And having a child was so desperately important for both of us.”

IVF already beats the old-fashioned way of getting pregnant, with a quarter of all attempts resulting in a baby. Still, fertility doctors around the world are hoping for further big improvements. If they can gain a better understanding of how embryos develop and implant in the womb, IVF could become a near-sure thing. But on current trends, even if the next big breakthrough is made in Britain, the benefits may be felt most strongly elsewhere.



WORLD
BRITAIN

Consumer banking

The high price of free accounts

Jul 17th 2008
From The Economist print edition

The competition watchdog's challenge may be more bark than bite

AMID the gloom of a faltering economy and a slumping housing market, Britain's banks, with their supervisors in hot pursuit, have been stumbling from one crisis to another. Having written off billions of pounds on the value of exotic credit products, and then tapped shareholders for billions more to rebuild strained balance sheets, banks have been bracing themselves for the next shoe to drop.

Most expected it to come in the form of writedowns on bad loans in their traditional banking business. Some analysts reckon these may total as much as £19 billion, if defaults rise to levels last seen in the previous downturn in the early 1990s. Yet trouble, as so often happens, has come from an unexpected direction.

The Office of Fair Trading (OFT), a consumer-and-competition watchdog, has spent over a year examining the market for current accounts. In a report published on July 16th the OFT said that the system lacks transparency and does not serve consumers. This stark finding is likely to trigger changes that may slash the profitability of the most lucrative bit of British retail banking at a time that banks need every penny they can get.

Although Britain's system of free current accounts for customers who keep them in credit has long been popular, it comes at a hefty price. The OFT reckons that in 2006 British banks raked in £8.3 billion from supposedly free current accounts, worth 31% of their total revenue from retail banking. Current accounts were a bigger source of income than mortgage lending (19%), credit cards (13%) and savings accounts (17%).

For consumers, the biggest cost arises from the paltry rates of interest that banks pay on balances held in current accounts, usually less than 0.5%, which compares with rates of 5% or 6% now available on savings accounts. This hidden fee totals £4.1 billion a year. Another £2.6 billion or so comes from the charges paid by customers who exceed their credit limits.

The OFT dislikes these arrangements for a number of reasons. It frets about cross-subsidies, saying that the burden of fees for exceeding credit limits falls on the young and the poor, who are in effect padding the accounts of the rich (and, although it does not say so, the careful). And by obscuring the costs of services that customers might use more sparingly if they had to pay a fee—withdrawing cash, for instance—cross-subsidies may be driving up expenses for all customers.

The OFT also worries that there is less competition between banks than there might be if the costs of accounts were more readily apparent to consumers. That too may drive up the burden of banking for all.

The OFT may have identified a problem in the retail-banking market but it has been reticent about proposing solutions. Instead, it wants banks to come forward with ideas for making current accounts more transparent. It hopes that by coming clean on what the accounts cost, banks will have to offer better deals to customers, who will be empowered to shop around more. At present only 6% of British customers change banks in any year, a far lower rate of switching than in many other industries—almost half of households switched electricity suppliers, for instance, in 2005.

But the OFT's hopes for the redemptive power of transparency may be unrealistic for two reasons, both mentioned in its own report. The first is that most customers choose a bank based on how close its nearest branch is and only a small minority consider the bank's charges. Another is that most people paying fees for exceeding their credit limits usually know what the charge is. Although only a quarter of customers go overdrawn each year, most of these had also done so the previous year and were more likely to do so six times a year than just once. Transparency may help cut costs, but only if customers take full advantage of it.

Planning shake-up

More haste, less speed

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From The Economist print edition

Worries about the new planning system could well turn into protests

AN INSIGHT often credited to Gordon Brown is that voters only notice a political message when it is reduced to a pithy soundbite and repeated endlessly. “Working hard for hard-working families” was a familiar trope during his decade as chancellor of the exchequer, as was the promise of “no return to boom and bust”. Nowadays the prime minister is most likely to be heard asserting his willingness, and the Conservative Party’s reluctance, to make “tough, long term decisions”.

In few policy areas does this self-professed capacity to do what is unpopular but necessary seem more apt than in planning, always a fraught issue in a crowded island with a reverence for the countryside. On July 16th, the House of Lords completed its second reading of a controversial government bill designed to speed up approval for infrastructure projects, such as power stations and motorways. Currently, local councils consider most planning applications, and ministers “call in” particularly contentious ones. A prolonged public inquiry often results. The new system will shift decision-making power to an independent Infrastructure Planning Commission (IPC), relegating the government’s role to setting out its vision for different types of infrastructure in a series of national policy statements.

Critics, who included many Labour MPs when the House of Commons passed the bill in June, worry about the loss of democratic control over sensitive issues, such as airport expansion. Mr Brown, some say, has been beguiled by the cult of experts ever since he transferred power over interest rates to the Bank of England to broad acclaim in 1997. The Tories, torn by instincts favouring growth on the one hand and the protection of the countryside and local interests on the other, describe the IPC as an over-mighty quango.

Ministers retort that a modern country cannot afford the interminable delays that blight the process of getting permission for large building projects in Britain, where the laws have barely been updated since the 1947 Town and Country Planning Act. Getting approval for a fifth terminal at Heathrow airport took seven years—a saga that did much to push the case for change. Speeding things up should save both time and money.

The government has already made some concessions. The new system will be reviewed after two years, and the chairman of the IPC will be scrutinised by MPs before taking office—making it harder for the government to install an apologist for growth-at-all-costs. Most important, the national policy statements will have to specify locations for nuclear power stations and airport developments—a power initially earmarked for the IPC.

But few doubt that the first controversial project to be given the go-ahead by the IPC will provoke outrage. And criticism of the bill goes beyond those hostile to development. Some, including the Tories, doubt whether the IPC would actually hasten approval for big projects as its decisions would be subject to judicial review. A dilution of democracy, with no efficiency gains to show for it, would be the worst of both worlds. Others say, rather implausibly, that there should be a single comprehensive national policy statement, rather than several separate ones, to allow for “joined-up thinking” on Britain’s infrastructure needs.

Criticism of the bill is loud, then, but the government insists that the burden of making hard choices in the national interest is exactly what distinguishes government from the luxury of opposition. The Tories are hearing the same tune from big business. On July 14th John Cridland, the deputy director-general of the Confederation of British Industry, a business lobby, implored the Tories to back the bill—saying that Britain would struggle to “keep the lights on” if new energy infrastructure were not built quickly. But that prompted a tart response from Jacqui Lait, the Tory planning spokesman, who described such language as alarmist and pointed out that the CBI had its own agenda to advance.

Britain’s planning system needs to change. But it is far from clear that the government’s proposals are the way to go.

Bagehot

Great expectations, no hope

Jul 17th 2008
From The Economist print edition

A hotly anticipated by-election that may well change nothing

Illustration by Steve O'Brien



THE east ends of Britain’s big cities have a special, mythical place in the national imagination. They are urban frontiers: gritty, sometimes lawless and eventful. History—trade unionism; radicalism; the temperance movement; industrial revolution; immigrant strife and striving—is packed into them as tightly as their inhabitants are, or, in the case of Glasgow, were. In Glasgow’s ruined east end, whole roads are vacant and vandalised; grotty pubs and discount stores dominate the grey high streets.

The Westminster by-election on July 24th in Glasgow East—one of the most deprived constituencies in Britain, and hitherto one of Labour’s safest seats—has been widely billed as another catalytic east-end drama: a pivotal episode in the rise of Scottish nationalism, a prime minister’s fall and the confrontation of entrenched social ills. It is likely to disappoint on all three fronts.

The by-election comes at a wonderful time for the Scottish National Party (SNP) and Alex Salmond, its wily leader. The SNP runs the devolved Scottish government—but only since last year, and without a majority in Scotland’s own parliament. That lets it trumpet its achievements while deflecting blame for its shortcomings (such as its failure to honour a pledge to cut school class sizes), and still, just, to portray itself as an insurgent party rather than a dowdy incumbent. Like the SNP’s symbolic victory in the dockyard constituency of Govan 20 years ago, overturning Labour’s majority of 13,507 in Glasgow East would be seen as a milestone on the high road to the ultimate goal of independence.

In fact, an SNP victory would mean little for the cause of Scottish separatism. The party’s mild-mannered candidate is campaigning not for independence but on a classic by-election slogan: as a chance to protest against Labour. A big vote for him will not indicate a surge of nationalism. That is true in Scotland generally: for all Mr Salmond’s canny bolshiness, popular support for independence has not risen in line with his party’s popularity.

Meanwhile the timing seems nightmarish for Gordon Brown. His opinion-poll numbers are flatlining. The local Labour party was chaotically divided even before the recent resignation of its leader in the Scottish Parliament. Losing Glasgow East would panic even the most phlegmatic Labour MPs. “The Clydeside MPs,” Mr Brown once wrote in his biography of James Maxton, an interwar east-end socialist, “had taken the slums and the dole queues…right to the doorstep of 10 Downing Street.” According to some excitable commentators, the voters of those same slums might help persuade Mr Brown’s party to yank him out.

The prime minister may indeed be deposed. But the by-election is unlikely to be the reason. Whatever the result, the moment of greatest peril for Mr Brown could be the autumn party conference, when would-be assassins will gather and plot. Anyway, for all the hyperventilation—Mr Salmond talks headily of a

“political earthquake”—Labour may hold on in Glasgow. Animosity to Mr Brown is not as violent as it is in England, where his Scottishness magnifies the spite (though for some in Glasgow he is insufficiently Scottish, a sort of Celtic Uncle Tom). Labour has found an impressive candidate, and the local demography is still powerfully supportive. The large Catholic vote has been devoutly loyal to Labour. The SNP’s bid to become the party of aspiration and the “Celtic tiger” economy might have swung a more prosperous seat; this one may be too poor for such blandishments.

Any sort of win anywhere would count as good news for Labour now. So Glasgow East may just turn out to be rather useful to Mr Brown. The reverse—whether more of Mr Brown, or indeed the SNP, will be useful to Glasgow East—is more doubtful.

Easterhouse is the east end’s best-known badland. Once said to be the biggest social-housing scheme in Europe, it has become a byword for shoddy urban planning (and one of the main prompts for Conservative thinking about poverty). “It was like a palace,” says a youth worker of the home his family moved to, in the 1960s, from an inner-city tenement. Then he points out the invisible boundaries between the turfs of rival Easterhouse gangs.

But for all the graffiti-strewn bus shelters, bits of Easterhouse are surprisingly smart. Neighbourhoods such as Parkhead and Shettleston are more desolate, with rows of once-grand Edwardian houses crumbling in picturesque decay, and empty lots and derelict shops a stone’s throw from city-centre streets that boast the highest rents in Scotland. Even in those areas, there are clusters of revamped homes. That, in a way, is the problem. As one observer puts it, housing is the easiest thing to renovate. It camouflages the off-the-scale incidence of unemployment, family breakdown and addiction. The London media has been competing to find the most exotic comparators for the catastrophically low local life expectancy: Gaza and North Korea are popular.

Always with us

What the east end needs is boldness. A higher proportion of people live on incapacity benefits in Glasgow East than anywhere else in Britain, a ruse used by successive governments to suppress the jobless count. Fixing the dependency means changing the incentives in the welfare system, but also a thorough infrastructure overhaul instead of patchwork fiddling (the Commonwealth games, which the city hosts in 2014, should help) and better training. There are jobs to be found in Glasgow, in call centres, hotels and retail (a huge forge that once employed thousands in the heart of the constituency is now a mega-mall). But many east-enders are not cut out for the service sector. All that will be costly and risky for city, regional and national politicians.

In 2001, as Tony Blair was preparing to call a general election, foot-and-mouth disease struck Britain’s farms. He was obliged to postpone it. How, people asked, can we vote when the countryside is suffering? Looked at objectively, the plight of Glasgow East is much more desperate; but it has become routine. Glasgow East will vote next week and, probably, not much will change.

Russia and the UN

The return of Mr Nyet

Jul 17th 2008 | MOSCOW AND NEW YORK
From The Economist print edition

An abrasive Russian veto is prompting fears at the UN of a new diplomatic logjam that recalls the bad old days

Corbis



IN THE corridors of the blue-tinted building on the East River, the shock is still palpable. Despite the recent insistence of Ban Ki-moon, the United Nations secretary-general, that human rights and security are intertwined, Russia and China have blocked an effort to isolate and punish the despots of Zimbabwe, in a move that seems to bode ill for action by the Security Council in other places.

Especially disappointing for many Westerners was the abrupt way in which Russia vetoed sanctions against President Robert Mugabe—only a day after Dmitry Medvedev, Russia's new head of state, had joined his partners in the Group of Eight, a rich-country club, in deploring Zimbabwe's rigged and violent elections. The G8 statement had included a warning of "financial and other measures against those individuals responsible for violence".

As many UN-watchers noted, Western governments were calculating that China—despite its substantial economic interests in Africa—would not want to exercise a sole veto. But Russia's apparent U-turn spared China the awkwardness of standing alone. "I have never seen so much frustration," said Warren Hoge of the International Peace Institute, a think-tank. "The Americans and British… thought the [Zimbabwe] resolution would at the most get abstentions from the Russians and Chinese." By the time the vote took place on July 11th, Western governments had realised (at least for a few hours) that a Sino-Russian block was unavoidable; but they let the vote proceed, if only to test the nay-sayers' resolve.

For Western governments that now face the prospect of working with Mr Medvedev over global hot spots from Iran to North Korea, the Zimbabwe veto raised several hard questions. Was there a failure of judgment by the new Russian leader? Was he overruled by other people, such as his predecessor, Vladimir Putin, who is now prime minister and was given formal responsibility this week for implementing foreign policy? Did Russia's sour mood reflect other gripes, say over America's vocal support for Georgia, or its missile-defence deal with the Czech Republic?

Other questions: was Russia boosting its own interests in southern Africa, or just acting up? And is the UN heading for a rerun of the cold war, when Soviet leaders like Nikita Khrushchev and his envoy Andrei Gromyko (pictured above) sparred with the West over almost everything?

The Kremlin, for its part, reacted peevishly to the West's dismay. Russian officials said there had been no

change in their policy, and that the West was once again distorting their position maliciously. The G8 statement had indeed carried Russia's signature, but it made no mention of UN sanctions. The main point, they added, was that Zimbabwe's travails posed no threat to regional or global stability; they were outside the Security Council's remit.

Such talk is consistent with a foreign-policy style that has altered little since Mr Medvedev took power. He may avoid Mr Putin's belligerent tone, but there is no sign of the Kremlin becoming friendlier to the West. Just to quash any doubts, Mr Putin has stressed that Mr Medvedev is "just as much a Russian nationalist, in a positive sense, as I am." Mr Medvedev has done his best to prove that point, repeating Mr Putin's warnings about American unilateralism. And even if Mr Medvedev wants to repair Russia's relations with the West, it seems unlikely that he has carved out any real power to make independent decisions, at least so far. This week, he told diplomats to be "more aggressive".

But none of this quite explains why Russia picked a fight with the West for the sake of a country in which it has no obvious interest. One reason, say Russia-watchers, is that punishing Mr Mugabe for stealing the elections and suppressing human rights sounded a bit close to the bone.

Indeed Russia's foreign ministry hinted at this when it said that punishing Mr Mugabe would "set a dangerous precedent, opening a way to the Security Council interfering in countries' internal affairs over various political events, including elections." Given the dictatorial nature of many of Russia's friends—like Belarus—and its own spotty record on human rights and elections, it is hardly surprising that Russia was unhappy about punitive sanctions against Zimbabwe.

In this climate, Western illusions that Russia might side with America against the regime in Zimbabwe betray a basic lack of understanding of what makes Russia tick, says Dmitri Trenin of the Carnegie Moscow Centre, a think-tank. These days, Russian thinking divides the world into America and its docile friends on one hand, and "sovereign" countries, like China, India and South Africa on the other. Given Russia's aim to speak for the second camp, its veto was logical—and as Russian officials stressed, it reflected the African Union line.

But Russia's move doesn't indicate that it has any constructive aim in southern Africa—other than exploiting whatever vestigial ties may linger from the era when Soviet arms (like the Kalashnikov, a national symbol in Mozambique) helped to overthrow white rule.

Ties that don't bind

Igor Sechin, one of Mr Putin's toughest aides, was once a Soviet "interpreter" in Mozambique, when it was in the grip of Marxist fervour. But even in those days, the Soviet attitude to Africa was ambivalent; as they dished out the rifles, its envoys used to mutter racist predictions about the likely effects of black rule.

And at the height of its involvement in southern Africa, the Soviet Union was often frustrated that its largesse did not translate into influence, says Georgi Derluguian, a professor at America's Northwestern University who worked as a Soviet adviser in Mozambique. But much more recently, a semi-official Russian foreign-policy report said Africa was still a zone of competition with the West. Western countries wanted "control over natural resources, dominance in consumer markets and decisive influence in [the region's] economic and political evolution," it thundered.

Compared with China, Russia's efforts to counter the West in Africa have so far been feeble; China's trade with Zimbabwe is ten times that of Russia. Although (or possibly, because) it has more interests at stake, China has seemed somewhat more amenable than Russia to arguments about the need to behave responsibly in Africa.

To many observers, it seems that the Kremlin's determination to play geopolitical games on every front could end up benefiting China, which is happy to let Russia take the blame for coddling dictators. But if Russia overplays the role of spoiler-in-chief, that could easily backfire. Mainly because of their veto rights, Russians are deeply attached to the UN as the only legitimate forum for solving geopolitical problems. Anatoly Gromyko (son of Andrei and a former head of the Soviet Union's Africa Institute) still speaks of the Security Council as the world's "greatest organ for maintaining stability".

But if Russia makes a habit of saying *nyet* to everything, in the churlish way that was a hallmark of the older Mr Gromyko, then the Security Council itself will lose effectiveness and prestige. And all its

permanent members (especially the weaker ones) would then lose out too.

Ivory sales

Round the horn

Jul 17th 2008
From The Economist print edition

Campaigners' fear for elephants, and their own credibility

BANNING almost all cross-border trade in ivory, as the United Nations did in 1989, doesn't seem to have achieved its stated aim, that of ending a smuggling business worth hundreds of millions of dollars a year. Soon the world will be able to assess the effects of a move in the other direction: a decision to let China bid at a one-off auction of legal ivory from four African countries whose elephant populations have stabilised. Hitherto Japan is the only country to have been authorised to make legal bids.

After some hard talking by Chinese officials who say they have clamped down on the black market, and campaigning by environmental groups that disagree, the decision went China's way at a meeting in Geneva of the Convention on International Trade in Endangered Species (CITES).

The International Fund for Animal Welfare (IFAW), a lobby group, said this condemns "the world's elephants to slaughter" and plays "Russian roulette" with a species whose numbers in some places, at least, are unknown but might be worryingly low. The campaigners' line is that legal sales merely abet the illegal kind, especially when the black market is way beyond officialdom's control.

Nobody can deny that China's black market was rampant until recently. In a report to the UN leaked by the Environmental Investigation Agency (EIA), a campaigning group, this month, Chinese officials admitted that between 1991 and 2002 they had lost sight of 121 tonnes of ivory, the equivalent of the tusks from 11,000 elephants.

Is China observing the CITES rules now? A brief visit to China in 2007 by inspectors from the CITES secretariat suggested that things had improved: they said that ivory was becoming harder to find, though they came across a shop in the city of Xi'an with ivory carvings of dubious provenance. A bigger investigation was carried out by TRAFFIC, an independent British-based group that monitors wildlife trade. After studying 10,000 shops between 2006 and 2008, it reported a progressive decline in the availability of illegal ivory. This had coincided with greater police vigilance.

The idea that China is cleaning up its act got another boost in March, when over 750kg (1,650lb) of raw ivory was seized in Guangxi Province. As CITES notes, the penalties for illegal trading include life imprisonment and death. But the EIA, which uses undercover methods to probe the trade, says things are not as good as they seem; in 2007 its researchers found a roomful of illegal ivory, including an uncut tusk, for sale in the city of Dalian. Last month they made a small find in Gansu province.

A more interesting question is how the legal sales now in prospect will affect the black market. A fresh supply of legal ivory may depress the price, and reduce the incentive to poach. TRAFFIC notes that after a legal auction in 1999, the price fell; this led to a decline in poaching over five years. For doctrinaire types, who oppose all trade in ivory, the forthcoming sale is not just a challenge to endangered animals; it could be a threat to the credibility of their best-loved arguments.

Winning or losing?

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From The Economist print edition

Dylan Thomas



Al-Qaeda has made terrorism truly global, to deadly effect. But it may yet prove to be its own worst enemy, says Anton La Guardia (interviewed here)

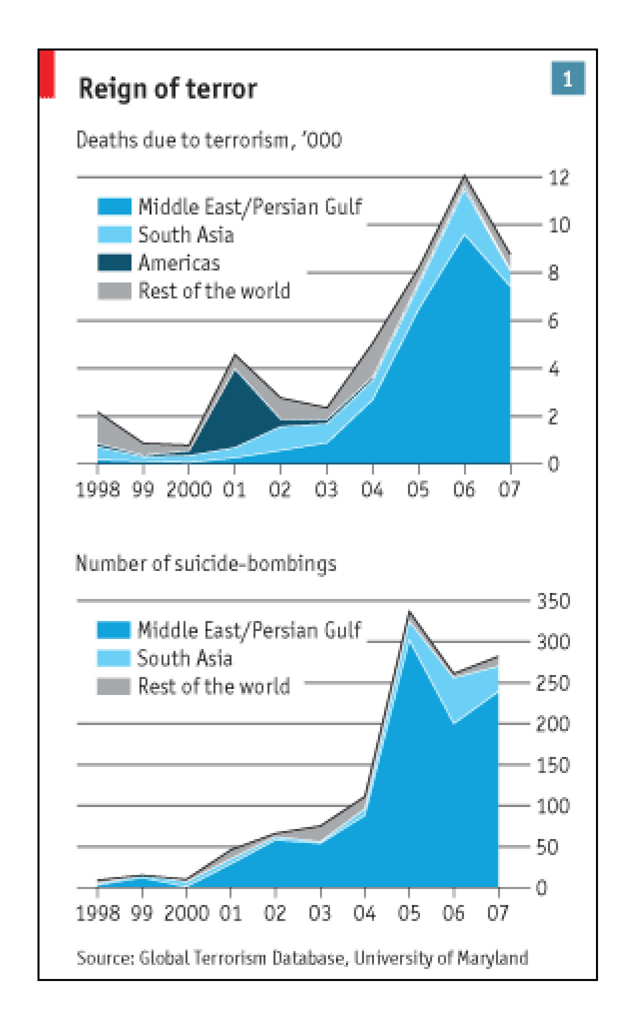
THESE days in Peshawar, where al-Qaeda was founded 20 years ago, the only glimpse of Osama bin Laden comes on little green packets of safety matches strewn around town by American officials (see picture). They bear the portrait of the world's most wanted man, along with the promise that America will pay up to $5 million for information leading to his capture.

It is an appropriate image. Like one of these matches, Mr bin Laden caused a flash with the September 11th attacks on America in 2001, then vanished into smoke, leaving a burning trail of militancy stretching from Indonesia to Afghanistan, Iraq, north Africa and Europe. And despite the reward offered for his capture, now $25m, nobody has yet betrayed the whereabouts of "the Sheikh", who periodically emerges on the internet to deliver some doom-laden warning to the West.

Nearly seven years into America's "global war on terror", the result remains inconclusive. Al-Qaeda lost a safe haven in Afghanistan, but is rebuilding another one in Pakistan; Mr bin Laden is at large, but Khalid Sheikh Mohammed, who masterminded September 11th, has gone on trial in Guantánamo Bay; many leaders have been captured or killed, but others have taken their place; al-Qaeda faces an ideological backlash, but young Muslims still volunteer to blow themselves up.

True, America has not been struck since 2001, but European capitals have been bombed. A number of plots have been averted on both sides of the Atlantic. Al-Qaeda and its nebula of like-minded groups still pose the most direct threat to the security of Western countries, and of many others besides. Western intelligence agencies are convinced al-Qaeda still wants to develop non-conventional weapons, whether chemical or biological agents or "dirty bombs" that create a cloud of radioactivity. In Iraq bombs are already mixed with chlorine gas. Even a rudimentary nuclear bomb, say the spooks, might not be beyond the reach of terrorists.

Al-Qaeda has built on decades of Middle Eastern terrorism. Palestinian groups internationalised their violence in the 1970s; Hizbullah used suicide-bombers against the Americans in Lebanon back in 1983; Palestinian suicide-bombers sought to inflict maximum civilian casualties in Israel from 1994; and Algerians who hijacked a French airliner the same year tried to fly it into the Eiffel Tower but were foiled.



In those days, though, attacking Western targets was part of a local nationalist or sectarian fight. Al-Qaeda's dark genius was to weave these strands together with the tools of globalisation to create a networked movement with a single worldwide cause: *jihad* against America. Conventional terrorist groups, such as the Basque ETA movement or even Lebanon's Hizbullah, often keep their violence in bounds to avoid alienating their political supporters. But global jihadists, without a domestic constituency, seek to maximise civilian casualties for spectacular effect. Counting the victims is tricky. Attacks on Western civilians have dropped, but the routine use of suicide-bombings has raised the slaughter, mostly of Muslims, to appalling levels (see chart 1).

Al-Qaeda's ideology was forged by one big victory and two decades of failures. Disparate Arab fighters who helped Afghan ones evict Soviet forces from Afghanistan in 1989 were initially elated, but became dejected by the ensuing civil war and the failure of violent campaigns in Egypt, Algeria and elsewhere. Many extremists decided to end the bloodletting. But a cadre of wandering jihadists gathered in Afghanistan under the protection of the Taliban and decided to redirect their ire from the "near" enemy to the "far" one.

The rationale was explained by Ayman al-Zawahiri, al-Qaeda's co-founder, in his memoirs, entitled "Knights Under the Prophet's Banner". The "Jewish-Crusader alliance", as he called the West, would never allow its local allies to be toppled. The answer was to attack America directly.

Such tactics would have several advantages, Mr Zawahiri said. They would deal "a blow to the great master". Given the depth of anti-Americanism across the Muslim world, they would "win over the nation". And the attacks would sow discord between Western countries and their local allies, presenting America with a dilemma: withdraw support from its friends or become directly involved in the Middle East. If America took military action, Mr Zawahiri argued, "the battle will turn into clear-cut *jihad* against the infidels," which Muslims were bound to support.

Seen in this light, one of the objectives of the September 11th attacks was to provoke the Americans into invading Muslim lands. But if al-Qaeda intended to trap America in Afghanistan, its plan went badly awry, at least initially. The Taliban fell quickly in 2001 and al-Qaeda's followers were forced into hiding.

A hubristic America, however, then walked into a trap of its own making by invading Iraq in 2003. It got rid of a dangerous dictator but gave the jihadists a popular cause against American occupiers in the Muslim heartland. For a while the jihadists thought they could carve out a base in Iraq from which to

destabilise the region. That danger may now have been averted. Helped by al-Qaeda's excesses, a bloodied America seems to be fighting its way out of the worst of the troubles it created for itself.

The beginning of the end?

So terrorism experts are now debating whether al-Qaeda is starting to burn itself out. "On balance, we are doing pretty well," Michael Hayden, the director of America's Central Intelligence Agency, told the *Washington Post* in May. "Near strategic defeat of al-Qaeda in Iraq. Near strategic defeat for al-Qaeda in Saudi Arabia. Significant setbacks for al-Qaeda globally—and here I'm going to use the word 'ideologically'—as a lot of the Islamic world pushes back on their form of Islam."

Many thought he was being overly optimistic. Had General Hayden himself not given warning two months earlier that the restoration of an al-Qaeda haven in Pakistan's tribal belt constituted a "clear and present danger" to the West?

A related argument has been provoked by "Leaderless Jihad", a book by Marc Sageman, a counter-terrorism consultant. He argues that al-Qaeda's core leadership has been "neutralised operationally". The bigger danger now comes from loose groups of Muslims in the West who radicalise each other and carry out autonomous, self-financed attacks.

This thesis has come in for strong criticism, particularly from Professor Bruce Hoffman of Georgetown University. He notes that al-Qaeda's imminent death has often been heralded in the past, only to be contradicted by the sound of new explosions. Many plots in Europe have direct connections back to Pakistan, he notes.

Part of the problem lies in al-Qaeda's diffuse nature. Its core members may number only hundreds, but it has connections of all kinds to militant groups with thousands or even tens of thousands of fighters. Al-Qaeda is a terrorist organisation, a militant network and a subculture of rebellion all at the same time.

To explain the movement, many experts draw parallels with globalisation. Some describe it as a venture-capital firm that invests in promising terrorist projects. Others speak of it as a global "brand" maintained by its leaders through their propaganda, with its growing number of "franchises" carrying out attacks.

The rise of al-Qaeda's stateless terrorism does not mean that the old state-sponsored variety has disappeared. Libya, which once supported the IRA and other violent causes, may now be co-operating with the West, but Iran, among others, supports both Palestinian militants and Lebanon's Hizbullah movement. Should Iran redirect Hizbullah towards a global terrorist campaign against the West—for instance, if the country's nuclear sites were bombed—the effect might be more devastating than any of al-Qaeda's works.

For the moment, though, the most immediate global threat comes from the ungoverned, undergoverned and ungovernable areas of the Muslim world. These include the Afghan-Pakistani border, the parts of Iraq still in turmoil, the Palestinian refugee camps in Lebanon, and swathes of Yemen, Somalia, the western Sahara desert and the chain of islands between Indonesia and the Philippines (see map).



Just as important as any of these is the “virtual caliphate” of cyberspace. The internet binds together the amorphous cloud of jihadist groups, spreads the ideology, weaves together the “single narrative” that Islam is under attack, popularises militant acts and distributes terrorist know-how. Because al-Qaeda is so dispersed, the fight against it has strained an international order still based on sovereign states.

This special report will attempt to answer the impossible question posed in 2003 in a leaked memo from Donald Rumsfeld, then America’s defence secretary: “Today, we lack metrics to know if we are winning or losing the global war on terror. Are we capturing, killing or deterring and dissuading more terrorists every day than the *madrassas* and the radical clerics are recruiting, training and deploying against us?”

A hydra-headed monster

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Al-Qaeda may have been cut down in Afghanistan, but it is growing in Pakistan's border area



THE Taliban Hotel has changed clientele. The abandoned Afghan homestead, close to the border with Pakistan, had long been used by insurgents as a resting place on their way to fight in Afghanistan; now it accommodates a contingent of American and Afghan soldiers.

This newest link in the chain of American border outposts is something of a fluke. The Americans discovered its importance only last September, when a patrol ran into a group of insurgents and found that the nearby hilltops provided good observation and electronic listening posts into Pakistan's ungoverned region of North Waziristan. “After three weeks there we decided we couldn't leave,” said Lieutenant-Colonel Michael Fenzel.

So now his men of the 1-503rd Airborne battalion are overseeing the construction of a new government and police compound, and a “cultural centre” that will be turned into a mosque. The Americans are trying to win over surrounding villagers with the promise of roads, construction jobs and government services. They are also hoping to organise a *jirga*, or council of elders, with tribesmen from both sides of the frontier to pacify the area.

This is a very different way of conducting military business than when the Americans first got to Afghanistan in 2001. Then the emphasis was on killing or capturing terrorists. Lots of civilians were killed in bombing raids. But as the Taliban insurgency in Afghanistan worsened in 2006 and Iraq slid towards bloody anarchy, American forces overhauled their tactics. The counter-insurgency manual issued in 2006 says their first task is to “protect the population”, assist economic development and improve governance in order to isolate the insurgents. American troops are no longer enjoined to “find, fix, finish” but to “clear, hold, build”. These methods are proving helpful. But there are too few troops, whether foreign or Afghan. And they can do little about the sanctuary on the other side of the border.

These days Pakistan's tribal belt along the frontier with Afghanistan makes up the world's most worrying reservoir of jihadists, containing an opaque mixture of Afghan and Pakistani Taliban, Pakistani sectarian extremists, Kashmiri militants and foreign fighters of all colours. Mixed in among them are al-Qaeda's senior leaders who, in the view of American officials, act as “force multipliers”—a small cadre, perhaps numbering only in the hundreds, who provide technical expertise, training, ideological rigour and sometimes funds.

All have been protected by the honour code of the Pushtun tribes, with whom foreign fighters have forged close relations since the days of the anti-Soviet *jihad*. Some of the foreigners have taken local wives, and many Pushtun warriors have embraced the ideology of global *jihad*.

The Pakistani tribal belt is less of a haven for al-Qaeda than Taliban-ruled Afghanistan had been before 2001. Yet it is secure enough, says last year's threat assessment by America's intelligence agencies, to provide al-Qaeda with many of the advantages it once derived from its base across the border in Afghanistan: a place to regroup its senior lieutenants, broadcast its propaganda, train a new generation of militants and plan fresh attacks around the world. Among those believed to be hiding in the tribal areas is Abu Khabab al-Masri, famous for being in charge of experiments with chemical and biological agents in which dogs were killed on video.

The Afghan insurgency is intensifying year by year; in May and June this year it was deadlier for Western troops than the Iraqi one. The Taliban and al-Qaeda are tantalisingly close to hand, yet distressingly hard to reach.

Pakistani forces, some of whose outposts are within shouting distance of American positions, play an ambiguous role: sometimes they turn a blind eye to the insurgents, and sometimes they help the Americans spot them. Relations between commanders on both sides of the border have usually been cordial. But ask American officers whether they regard Pakistan as a friend or a foe, and many reply: "Both."

On June 10th American jets killed 11 members of Pakistan's Frontier Corps during bombing raids against insurgents on the border of Afghanistan's Kunar province. Five days later, after a brazen Taliban attack on Kandahar prison that freed 1,000 inmates, including about 400 Taliban, Afghanistan's president, Hamid Karzai, threatened to send his forces into Pakistan. His officials claim Pakistani intelligence was behind a recent attempt to kill him.

American soldiers do sometimes fire into Pakistan, and special forces and the CIA work together to gather information on the big fish across the frontier. Once in a while missiles go off from American unmanned aircraft or ground artillery to strike at wanted men. American officers recognise that, even with the best will of the world, the Pakistani army would struggle to keep control of its remote frontier. The question these days is how hard it is trying.

When Pakistan was founded as a Muslim state at the partition of British India in 1947, the colonial border arrangements were left largely unchanged. The frontier with Afghanistan was always fuzzy. A strip of mountainous territory on the Pakistani side, carved out by the British as a buffer zone, remained as autonomous tribal lands whose population had few of the rights accorded to other Pakistani citizens.

The seven districts of the Federally Administered Tribal Areas (FATA) are run at arm's length by the president's office through the governor of the North-West Frontier Province (NWFP) and the "agents" he appoints among tribal elders. FATA has been one of Pakistan's most neglected regions. Income per person is half the (already low) national average.

Successive Pakistani governments have encouraged the tribes to emphasise their Islamic rather than their Pushtun identity. Pakistan (together with America and Saudi Arabia) supported the anti-Soviet *jihad* and later it backed the Taliban. Afghanistan, it felt, offered "strategic depth" in case of war with India.

President Pervez Musharraf made an abrupt U-turn by co-operating with America in toppling the Taliban in 2001, but although he sent the army into FATA to hunt the remnants of al-Qaeda, he allowed the Taliban to regroup. Apologists say Mr Musharraf could not take on too many enemies and had other things to worry about. Critics retort that he deliberately sought to destabilise Afghanistan or, more charitably, that he hedged his bet because he feared America would soon withdraw.

Pakistan's military campaign hurt al-Qaeda, at least for a time. Intercepted letters from Ayman al-Zawahiri and other al-Qaeda figures, written in 2005, complain of weakness, shortage of funds, difficulties communicating with the outside world and the ever-present fear of arrest or assassination. Nevertheless al-Qaeda proved hard to separate from the Taliban, and the Pakistani army suffered painful losses in the ensuing clashes. In 2006 Mr Musharraf agreed to a truce. All this left both al-Qaeda and the Taliban stronger than before; worse, the Taliban acquired a Pakistani branch that spread violence and radicalism across the country. Last December Benazir Bhutto, a Pakistani opposition leader, was killed in an attack for which the Americans blamed the Pakistani Taliban.

Mr Musharraf thus finds himself attacked by Americans for failing to curb militants, and by militants (and many Pakistanis) for being an American stooge. After eight years of military rule, Pakistanis earlier this year voted the opposition into power. But the country is still confused, even in denial, over the threat from militants.

Sounding the retreat

Events in South Waziristan, the largest of the tribal agencies, are particularly worrying. Last month the Pakistani army invited journalists on a rare visit to the area to see how it had dealt with the tribal redoubt of Baitullah Mehsud, the leader of the Tehrik-i-Taliban, the umbrella group of the Pakistani Taliban. In January the army told some 200,000 people to leave their homes before sweeping through with attack helicopters, artillery and tanks.

A few days after the journalists' visit, Mr Mehsud summoned them back to the region to demonstrate that he remained in charge. The Taliban leader, surrounded by hundreds of long-haired fighters, denied accusations that he had ordered the killing of Ms Bhutto, blaming Mr Musharraf instead. He said he would not agree to stop cross-border attacks: "Islam does not recognise frontiers and borders."

Pakistan's prime minister, Yousaf Raza Gilani, insists that his new civilian government must be left to deal with extremism in its own way. He says the government will fight terrorists vigorously, but has to regain the support of a sceptical public. The tribal areas need to be integrated into the rest of the country both politically and economically in order to isolate extremists. Peace deals have already been signed in the "settled" areas of NWFP, but Mr Gilani insists that "no talks will be held with anyone refusing to lay down arms."

All this sounds very similar to what the Americans are trying to do across the border in Afghanistan, yet they are not reassured. It is the army, not the government, that is in charge of the talks, and the Americans fear that it will surrender control to the Taliban and al-Qaeda, as it has done in the past. And the talks will do nothing to improve matters in Baluchistan, the seat of the main body of Taliban leaders known as the "Quetta Shura", that runs the most intense front of the insurgency in the southern provinces of Kandahar and Helmand, apparently untroubled by the Pakistani authorities.

America would like to see Pakistan adopt some of its counter-insurgency methods to strengthen its grip on the tribal areas, and is offering about $750m over five years for social and economic development in FATA. But the Pakistani army seems reluctant to change its thinking. Having lost about 1,000 soldiers since 2001 and had 250 of its soldiers captured by Mr Mehsud's fighters, it is tired and demoralised. NATO says the number of cross-border infiltrations has risen sharply this year.

One bit of hopeful news was the rout of Islamist parties in NWFP in the recent election, where the winner was the secular Pushtun nationalist party, the Awami National Party, which opposes the militants. But the provincial capital, Peshawar, is surrounded by armed groups, prompting a paramilitary operation to stop the city falling into their hands. The province's chief minister, Ameer Haider Hoti, claims that past Pakistani governments had built up armed factions as a tool of foreign policy. Now, he says, "this monster was created, and nobody knows how to handle it."

Economist.com SPECIAL REPORTS

Hearts and minds

Jul 17th 2008
From The Economist print edition

Al-Qaeda's star is falling in Iraq but rising in the Maghreb

THE "Islamic State of Iraq", as al-Qaeda and its jihadist allies in that country like to call themselves, pumps out a stream of triumphant videos showing its fighters blowing up American Humvees. But these days the swagger has gone as the jihadists have been greatly weakened by the Americans and Sunni tribesmen. Their predicament was summed up in an interview by a man calling himself Abu Turab al-Jazairi. Described as one of al-Qaeda's leaders in northern Iraq, the movement's last bastion, he acknowledged losing several cities "because a large number of tribal leaders betrayed Islam". And some of al-Qaeda's fighters "got carried away with murdering and executions".

One of America's justifications for invading Iraq in 2003 was that Saddam Hussein was supporting al-Qaeda. That claim, like the one that he had weapons of mass destruction, has been discredited. In fact, it was the invasion of Iraq that revived al-Qaeda after its eviction from Afghanistan in 2001. By early 2006, America's National Intelligence Assessment on terrorism concluded that the Iraq conflict was "breeding a deep resentment of US involvement in the Muslim world and cultivating supporters for the global jihadist movement".

The war in Iraq has cost the lives of more than 4,000 American soldiers, done grievous harm to the country's reputation and run up a bill of hundreds of billions, perhaps trillions of dollars. Al-Qaeda can claim a large part of the credit for inflicting this damage. It grafted itself onto a local Sunni insurgency and carried out many of the bloodiest suicide-bombings that wrecked the prospect of an early political settlement and provoked a sectarian war.

In June 2006 American forces tracked down the organisation's leader in Iraq, Abu Musab al-Zarqawi, and killed him in a bombing raid on his hideout north of Baghdad. Even so, a bleak Marine Corps intelligence report in the summer of 2006 found that American and Iraqi troops were "no longer capable of militarily defeating the insurgency in Anbar".

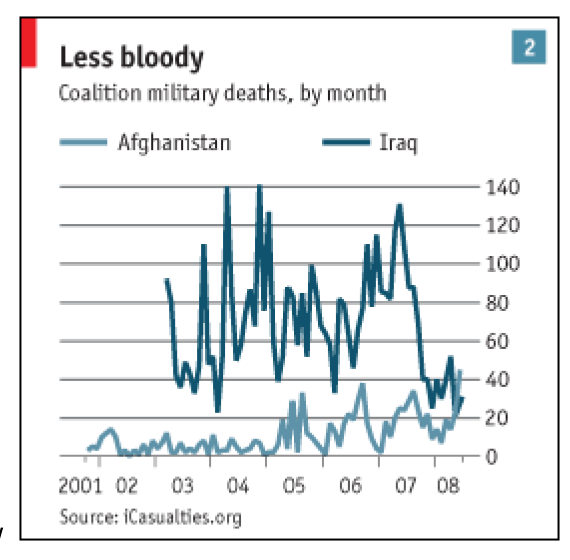
Al-Qaeda hoped to create a base in the heart of the Islamist world from where it could extend the war to neighbouring countries and, ultimately, take on Israel itself. An intercepted letter to Zarqawi in October 2005 from Mr Zawahiri, al-Qaeda's co-founder, predicted that the Americans would withdraw "soon" and urged him to prepare to fill the void. But Mr Zawahiri also advised Zarqawi, who was known as "Sheikh of the Slaughterers" because he liked to behead enemies, to go easy on the bloodletting because it was putting off ordinary Muslims.

Al-Qaeda had initially been welcomed as a champion of the Sunni cause against the Americans and the Shia. But many Sunnis soon came to see the organisation as a brutal imposition, killing anybody it considered a traitor or insufficiently pious. Some tribes in Anbar province had tried to turn against al-Qaeda in 2005, but their leaders were killed.

When Colonel Sean MacFarland of the 1st Armoured division took charge of Ramadi, Anbar's capital, in early 2006, he felt that the city was in "enemy hands". To retake it he needed more Iraqi recruits, so he decided to woo local leaders who had *wasta*, or influence. His first task was to protect those sheikhs who had moved over to the Americans. They became the conduits of American humanitarian assistance. In neighbourhoods where security was improving, the Americans also got the infrastructure repaired and the machinery of government restored.

The Americans and their new Iraqi allies pushed into al-Qaeda's strongholds, retaking Ramadi neighbourhood by neighbourhood, combining American firepower and Iraqi knowledge. This started a virtuous circle in which tribal sheikhs felt secure enough to join in, in turn increasing security. This "Awakening" has since spread beyond the original province of Anbar, pushing al-Qaeda further northward.

The other engine of violence in Iraq, Shia sectarian killings, has also lost power, thanks to American security measures and the ceasefire declared by Muqtada al-Sadr, a radical cleric, in August 2007. Insurgent attacks are now at their lowest level since 2004; the number of American soldiers killed dropped to 19 in May, the lowest monthly total since the invasion of Iraq (see chart 2).



A turn for the better

Grit, determination, an eleventh-hour change of tactics and the Sunni tribal movement helped America to avoid the defeat in Iraq that seemed perilously close less than two years ago. Al-Qaeda is not so much fighting to beat America in Iraq but to survive. Increasingly, say Western officials, foreign fighters now prefer to take themselves to Pakistan.

But counter-terrorism experts worry about the consequences of America's success. Might Iraq now start exporting seasoned veterans, as Afghanistan did in the 1990s? Optimists say the danger is less acute than many fear, for three reasons. First, many of the foreign jihadists went to Iraq on a one-way ticket: to die as suicide-bombers. Second, governments are more aware of the danger of returning jihadists. And third, Zarqawi's death seems to have removed the main impetus behind exporting Iraq's violence.

Zarqawi's decision to bomb three hotels in Amman in November 2005 backfired badly, causing a wave of revulsion, especially in his native Jordan. Among the bombed-out ruins of his hideout, American forces found a letter from a man calling himself Atiyah who said he spoke on behalf of the whole of al-Qaeda's leadership. Written just weeks after the Amman bombs, it warned Zarqawi that his actions were alienating potential supporters. He risked repeating the jihadists' ruinous bloodletting in Algeria during the 1990s when, Atiyah said, "their enemy did not defeat them, but rather they defeated themselves, were consumed and fell."

The savagery of the Algerian *jihad* took the lives of more than 100,000 people through the 1990s. The worst of the fighting was waged by the Armed Islamic Group (GIA), which denounced democracy and embraced *jihad* as the only means to power. The Salafist Group for Preaching and Combat (GSPC), broke away in 1998. It had always been close to al-Qaeda, with strong links to fighters in Iraq.

In September 2006, thanks in part to matchmaking by Zarqawi, the GSPC rebranded itself as al-Qaeda in the Islamic Maghreb (AQIM) and introduced suicide tactics, attacking a series of foreign targets, including the United Nations office in Algiers. It also kidnapped Western tourists in Mauritania and Tunisia. The jihadists use the vast expanse of the Sahara to train recruits from across the region.

Other al-Qaeda offshoots have emerged, for instance, in Yemen and Lebanon. Whether these franchises will fare any better than Algeria's earlier kind of jihadism, or than the troubled one in Iraq, remains to be seen. Mr Jazairi, for one, thought the bombings in his native Algeria were "sheer idiocy". Better to fight in Iraq, he said. Still, it may be only a matter of time before AQIM, in particular, leaps across the Mediterranean into Europe.

Doing their own thing

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Unlike in America, terrorism in Europe is often home-grown

SITTING in front of a black flag inscribed with a Koranic verse, Umar Islam jabs his finger at the camera. "As you kill, you will be killed. And if you want to kill our women and children, then the same thing will happen to you."

Mr Islam, a 30-year-old convert once known as Brian Young, lists the transgressions of his fellow Britons: they have sons and daughters serving as soldiers in "Muslim lands"; they pay taxes to support the army; and they have not pushed hard enough to remove their leaders. Worse, they are too obsessed with television soap operas and sport to know what is happening. "Most of you are too busy watching 'Home and Away' and 'Eastenders', complaining about the World Cup and drinking your alcohol...I know because I've come from that."

Other members take turns to harangue their country on video, among them the apparent leader of the gang, Abdulla Ahmed Ali, who complains that the British are more concerned about the killing of foxes than of Muslims. These "martyrdom videos", adding some British flavour to the themes of global *jihad*, were never broadcast. They were found by British police during a wave of arrests in August 2006 and shown at the trial of eight men accused of attempting to blow up seven or more transatlantic airliners en route from London to North America. Mr Ali denies that the group meant to kill anybody; it was planning only a small explosion at London's Heathrow airport to attract publicity, he told the court.

If the prosecution were to prove its case, the alleged plot would have been the biggest since the September 11th 2001 attacks on America, potentially killing between 1,000 and 2,000 people. Even without this case, though, it is plain that Europe is now bearing the brunt of jihadist attacks on the West, even though America is seen as the main enemy. Ten remotely controlled bombs were set off on Madrid's trains on March 11th 2004, killing 191 people, and four suicide-bombers blew themselves up on London's public transport on July 7th 2005, killing 52. Since then, several more bombs failed to detonate properly in London and Glasgow, and other attacks were foiled across Europe.

For America, the terrorist threat is still mainly an external one, involving extremists coming from abroad to carry out attacks. In Europe it is largely an internal problem of home-grown Muslim extremists. This helps to explain why Americans see the struggle against jihadism as a "war", whereas Europeans consider it mainly a matter for the police; why America is attracted by the idea of fighting terrorists "over there", whereas Europe worries that military action will only worsen the problem "over here". Indeed, the biggest threat to America may come from "clean skin" European extremists.

Marc Sageman, in his book "Leaderless Jihad", argues that these European-born radicals, usually descendants of poor migrants, are drawn to violence less by religious ideology and more by the idea of "jihadist cool". They may know little about the Koran, but feel a sense of outrage and want to emulate the heroic figures they see on militant internet clips. These groups of friends, says Mr Sageman, become radicalised on their own. As international security has tightened, they have been unable to reach Iraq or Pakistan to fight there or were sent back, so they fight at home instead.

Ed Husain, a former member of the militant Hizb ut-Tahrir group in Britain and now co-director of the Quilliam Foundation, a think-tank set up to counter extremism, says that many young Muslims see radical Islam as a means of asserting their identity: "It gives you a sense of rebellion but you don't feel bad about it. You are doing God's work."

Not over here

So why do Muslims in America seem more immune from militancy? According to Mr Sageman, the idea of a "war on Islam" makes less sense to them because of America's more inclusive attitude to the immigrants, greater social mobility and the bigger role religion plays in public life. Others point out that

Muslims in America form a smaller proportion of the population, are more dispersed and usually have higher skills than in Europe.

Counter-terrorism officials say the main reason America has avoided another attack is that it is farther from al-Qaeda's main battlegrounds. With greatly improved intelligence co-operation, and with hundreds of thousands of people barred from travelling to America, al-Qaeda finds it easier to strike at Europe.

In Britain, the number of jihadist suspects tracked by MI5, the domestic intelligence service, keeps rising. Last year Jonathan Evans, the head of MI5, said his agency was watching about 2,000 people deemed to pose a direct threat to national security and public safety. He dismissed the idea of a leaderless movement. Terrorist attacks in Britain, whether successful or foiled, "are not simply random plots by disparate and fragmented groups", he insisted. Rather, most "have taken place because al-Qaeda has a clear determination to mount terrorist attacks against the United Kingdom".

Britain's prominent role in Iraq and Afghanistan, coupled with a large resident population of Pakistani descent, puts it at greater risk of attack than others. But many other European countries also have substantial Muslim minorities. Germany's opposition to the war in Iraq offered little protection; it was just luck that two bombs failed to go off on commuter trains in 2006. Last September German police foiled an alleged plot to bomb several places that attracted American visitors. Denmark has been climbing up the jihadists' hate-list ever since one of its newspapers published some cartoons deemed offensive to the Prophet Muhammad in 2005.

France suffered Iranian-inspired bombings in the 1980s and Algerian ones in the 1990s, but has remained largely unscathed in recent years, thanks in part to a well-oiled counter-terrorist apparatus. Still, French security officials expect more attacks, given the violent stirrings of al-Qaeda in the Maghreb. Spain and Italy are also worried.

As Europe's prisons fill with jihadists, there are fears that radicalisation will spread among inmates. In Britain, police are particularly concerned that jihadists will form links with black criminal gangs, giving them access to weapons. In Spain in 2004, police arrested a group that had hatched a plot in prison to blow up Spain's High Court and kill its leading antiterrorism judge, Baltasar Garzón.

The following year, police in Los Angeles stumbled on a group led by an ex-convict convert to Islam that was planning to bomb military recruitment stations, the Israeli consulate and synagogues. The trouble with prisons, says an FBI source, is that inmates are already predisposed to violence. America may not be as immune from home-grown terrorism as it thinks.

Bending the rules

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The high cost of Guantánamo Bay

IT SHOULD have been the start of catharsis: justice would be seen to be done when the man who had boasted of masterminding the September 11th attacks on America was made to answer for his crimes. Instead, the arraignment hearing of Khalid Sheikh Mohammed and four other al-Qaeda suspects became another instalment in the long-running farce—or tragedy—of America's prison camp at Guantánamo Bay.

"KSM", as security types usually refer to the camp's most famous inmate, was chatting, laughing and reciting Koranic verses throughout the proceedings. He told the military judge that he welcomed the prospect of a death sentence. "I have been looking to be a martyr [for] a long time."

The Geneva Conventions, which America belatedly recognises as applying to the camp's "unlawful enemy combatants", protect prisoners from being paraded in public. KSM had to approve an artist's sketch of him in court, but complained that his nose had been drawn too big. The artist agreed it was "a little beaky" and rushed off to change it.

Guantánamo Bay became a symbol of legal abuse, maltreatment and torture from the moment the first orange-clad inmates stumbled in with their shackles, blindfolds and earmuffs in early 2002. It was built in the belief that, as an American base on leased Cuban soil, it was beyond the reach of America's federal courts. But that rationale has been dismantled by successive rulings of the Supreme Court. Last month, by a narrow vote of five to four, the court recognised the inmates' right to seek their freedom before a federal judge.

Still, the legal process ahead is likely to be messy, because the Supreme Court has left much unsaid. It did not pronounce on the legality of the military commissions, the standard of proof required to be held in detention, the admissibility of evidence obtained under duress, and what access prisoners will have to secret information. Moreover, the ruling does not cover the roughly 21,000 prisoners held by American forces in Iraq or the 650-odd in Bagram in Afghanistan, which get far less scrutiny.

Donald Rumsfeld, the former American defence secretary, famously said that Guantánamo Bay was meant to house the "worst of the worst". Yet the majority of the 780 or so prisoners who have passed through the hands of the interrogators there have been sent back to their home countries without charge.

Of the remaining 270, only 20 have had charges for war crimes filed against them. Between 60 and 80 may eventually be prosecuted. About 60 have been approved for release but for various reasons cannot go. That leaves an awkward group of perhaps 120 against whom there is insufficient evidence to prosecute but who are still considered dangerous. Some legal experts argue that a new national security court should decide whether they can be interned without trial.

According to a tally by the Centre on Law and Security at New York University, American civilian courts have convicted more than 80 people, mostly Americans, on terrorism charges, whereas the military commissions at the camp have processed only one case.

Doubtful legality, doubtful value

Guantánamo Bay has become an embarrassment. Even President George Bush has said he wants to shut it down. Both the Democratic and the Republican candidates to succeed him in his job have promised to do so.

Guantánamo Bay has two main functions aside from handing out justice: to stop potential fighters from returning to the "battlefield" (which could mean indefinite imprisonment) and to gather intelligence. The Bush administration claims that its dark web of security measures—including "waterboarding" (simulated

drowning) of prisoners, secret CIA prisons and the “rendition” of suspects to their countries of origin, where they may be tortured—have saved countless lives and generated a wealth of information. Perhaps so. But it is impossible to judge the quality of such information, or to know how many other lives have been lost or endangered by the outrage that such methods have caused among Muslims.

Certainly those methods have proved an obstacle to international co-operation, a vital component of the fight against global terrorism. Even as some Western countries have hardened their antiterrorist legislation, extending periods of detention without charge, widening conspiracy laws and restricting free speech, they have viewed America’s attempts to bend the rules with suspicion.

Mr Garzón, Spain’s best-known investigating judge, is baffled by America’s refusal to give him information about the whereabouts of Mustafa Setmarian Nasar, a prominent al-Qaeda ideologue wanted in Spain in connection with the Madrid bombings. Mr Nasar is widely reported to have been arrested in Pakistan and handed over to the Americans, but he does not figure on any list of detainees.

Hamed Abderrahaman Ahmad, a Spaniard sentenced to six years in prison for membership of al-Qaeda, had his conviction overturned by the Spanish courts in 2006 in part because it had been based on possibly tainted evidence gathered at Guantánamo. In March this year Mr Garzón dropped his request for the extradition to Spain of two British residents recently freed from the camp, on the ground that the mental and physical suffering they had endured made prosecution impossible.

Likewise, Peter Clarke, a former British counter-terrorism police chief who advises Policy Exchange, a London-based think-tank, says that “any evidence obtained in Guantánamo is inadmissible.” He also underlines the moral power of criminal prosecution; after a spate of terrorism-related convictions (and guilty pleas) in Britain, he says, the dialogue with British Muslims may now become more constructive. Indeed, British Muslims have started to report suspicious activity to the police, leading to at least one arrest. In an age of fragmented, even “leaderless” jihadists, that kind of intelligence volunteered may prove much more helpful than the sort extracted by simulated drowning.

Powers of persuasion

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Saudi Arabia tackles terrorism with a mixture of tough policing and gentle re-education

YOUSUF AL-AYEERI, al-Qaeda's ex-leader in Saudi Arabia, was not ready when the order came to open a new front in the land of Mecca and Medina. He had told his commanders, in a letter written in the coded language of a football coach, that his "teams" were not yet strong enough; they could play some away games in neighbouring countries, but it would be best to wait six months to build up a fan base in Saudi Arabia, particularly among religious authorities.

But according to Saudi security sources, Seif al-Adel, a senior al-Qaeda leader in Iran, insisted that the time was ripe to take on the House of Saud. Saudi Arabia's relations with America, its main protector, were badly strained after the September 11th attacks (15 of the 19 hijackers were Saudis), and America's invasion of Iraq in March 2003 had riled Muslims. For Osama bin Laden, one of al-Qaeda's main aims had always been to depose the "tyrants" who had let American troops into his native country in 1991. In April 2003 the Americans announced their intention to leave. Yet on May 12th 2003 three suicide squads set off car-bombs in Western residential compounds, killing 26 people. It was the start of the most serious al-Qaeda campaign outside Iraq, targeting Western compounds, Saudi police offices and oil installations.

Within two years, however, the Saudi authorities seemed to have got a firm grip on the militants. Their policy mixed hard-nosed security operations and an extensive deradicalisation programme in the prisons with social measures for the families of militants. These days, Saudi Arabia, often considered the fount of hardline ideology and finance for jihadists, is seen by many as a model for fighting terrorism.

After the downfall of the Taliban, the Saudis had been on the lookout for al-Qaeda veterans returning from Afghanistan. When explosives were accidentally set off in Riyadh in May 2003, say Saudi officials, security forces found a vast cache of weapons. The interior ministry put out a list of 19 wanted men. But a few days later the first suicide car-bombs exploded.

Initially, the militants seemed to enjoy a degree of public backing. "When the attacks started, the mosques were almost supporting them. We could not arrest 35,000 imams," said a Saudi security source. But the police and the national guard carried out hundreds of raids and learnt fast. They killed Ayeeri within a month of the attacks and three more leaders within the next two years.

Al-Qaeda, for its part, was bumping off ever more Muslims. A lorry-bomb in Riyadh in November 2003 killed mostly Muslim expatriates. When the militants struck a building used mainly by the Saudi traffic police in April 2004, the dead included a child.

For the past three years, al-Qaeda in Saudi Arabia appears to have become increasingly fragmented, with no clear leadership or methodology. Alms-giving and money transfers, the main sources of terrorist funding, have been restricted to the point where some Western diplomats say it could drive all charitable donations underground and become counterproductive. *Sawt al-Jihad* (*Voice of Jihad*), one the best-known jihadi online magazines, disappeared for more than two years. "They underestimated the Saudi police," says a senior security source. "But we are fortunate they started prematurely. If they had listened to Ayeeri maybe they would be in a different position."

Although fragmented, al-Qaeda is still active. A twin car-bomb attack on Saudi Arabia's main oil-processing facility at Abqaiq was only narrowly averted in February 2006, and militants have made at least five other attempts to strike at the oil infrastructure. Security sources say a Saudi general was killed at his home by some of his own tribesmen last year when they returned from Iraq.

The war of ideas

As the centre of Muslim pilgrimage, Saudi Arabia will always be a place for extremists from across the

world to meet and plot, sometimes carrying secret messages. Still, the level of violence has dropped, and the country can put more effort into the war of ideas. Official propaganda talks of extremists as "misguided" or deviant. It avoids terms such as *jihadi* or *irhabi* (Arabic for "terrorist") because they are derived from Koranic verses with positive connotations. Saudi officials note that Sura 8:60 commands the faithful to "strike terror into the enemies of Allah". Saudi Arabia treats jihadists as victims rather than as terrorists. Jailed militants are offered one-on-one discussions with Islamic scholars to try to convince them that they have misinterpreted the rules of *jihad*.

Those due for release after serving short sentences for, say, fighting in Iraq undergo rehabilitation in a low-security holiday camp outside Riyadh. Other inmates have served time at Guantánamo Bay. The young men spend their days in religious discussions, art therapy, sports, vocational training and psychological assessments.

One of those who recently attended the course was 30-year-old Abdallah al-Sufyani, a lovelorn former university student from Taif. He decided to go to Iraq in 2003 after his secret girlfriend was made to marry another man. He wanted to die, but believed he would go to hell if he committed suicide. His answer was to fight the Americans and hope he would be killed as a martyr. But he survived and eventually returned home. "I did not find the truth in Iraq," he says. "I found Muslims killing Muslims, Iraqis killing Iraqis." Now, with the help of the Saudi government, he hopes to write a book and launch a poetry magazine.

Inmates on rehabilitation are encouraged to reconnect with friends and family on frequent home visits. When they leave, the state gives them money if they have no job, helps them find work, buys them a car and even assists them in finding a wife. Family members are looked after too, to ensure they are not recruited by extremists. Friends, relatives and tribal elders are enlisted to ensure good behaviour. The system of subsidy and patronage is so generous that Saudis quip they wish they had been in Tora Bora with Osama bin Laden.

The rate of recidivism is not known. Two former Guantánamo inmates are back in prison, but even that may be a sign of progress. "Do you know who told us about them? Their friends," says a senior Saudi source.

As for the hardcore militants, the government has a different plan. About 700 people are currently in jail pending prosecution on terrorism-related charges. Five new high-security prisons for militants, with room for thousands, are being built by none other than the bin Laden family's construction firm.

Some 75 people involved in the explosions in 2003 are due to be tried this year. The government wants them to be dealt with by the sternest of Wahhabi religious scholars. "It should not be a trial of the people," says a senior Saudi figure, "it should be a trial of the ideology of al-Qaeda. The real victory over al-Qaeda will be when we defeat the ideology."

Economist.com SPECIAL REPORTS

The self-destructive gene

Jul 17th 2008
From The Economist print edition

Al-Qaeda's biggest weakness is its propensity to kill indiscriminately

THE mangonel was the big gun of antiquity. But this siege engine, used to catapult rocks, burning objects or dead animals into fortified cities, troubled Islamic scholars. Some early authorities disallowed it on the ground that it was an indiscriminate weapon.

From the Crusades onwards it met with greater approval. Ibn al-Nahhas al-Dumyati, a classical writer on *jihad* who fought the Crusaders, ruled that mangonels could be used against the enemy "even if there are women and children among them, even if there are Muslim prisoners, merchants or those who have been granted safe conduct".

Such opinions are cited today in religious rulings defending the September 11th attacks or arguing that weapons of mass destruction may be used against America. But Jihadists of al-Qaeda's sort disregard long-standing injunctions against wanton slaughter. Worse, they claim the right to declare *takfir*, or apostasy among Muslims. When combined with a puritanical religious practice known as *salafism*—imitating the earliest Muslims, known as the *salaf*, and treating later Islamic practices with contempt—this creates an especially violent and intolerant kind of Muslim.

Salafi-takfiri jihadists cannot build political alliances; they regard even Hamas and Hizbullah, Israel's main foes, as corrupted by politics. And once they start to spill blood, they become ever more indiscriminate: first they attack the "apostate" rulers or their foreign backers, then the ministers, then the security forces, then the civil servants, then anybody who objects to the violence, and so on. Those who recoil at the carnage, or object to the religious strictures imposed at gunpoint, are treated as apostates. At some point, though, local populations turn against their supposed champions.

This cycle of escalation and rejection was demonstrated in Algeria, Egypt, Saudi Arabia and, most recently, Iraq. Peter Bergen, the author of several books on Osama bin Laden, suggests that al-Qaeda, in turn, is starting to unravel. "Self-destruction is encoded in the DNA of groups like al-Qaeda," he says.

A Pew Global Attitudes survey last year found that support for Mr bin Laden and suicide-bombings had dropped across a number of Muslim countries. More importantly, even radical ideologues have become critical. Salman al-Oadah, a Saudi sheikh once jailed by the Saudi authorities and admired by Mr bin Laden, last year made a televised appeal for the al-Qaeda leader to change his violent ways.

Another blow was delivered from an Egyptian jail by Sayyid Imam al-Sharif, better known as Dr Fadl, one of al-Qaeda's founders in 1988 and a former leader of Mr Zawahiri's movement, al-Jihad. He had developed much of al-Qaeda's ideology, but at the end of last year he came up with a sweeping revision. "There is nothing that invokes the anger of God and His wrath like the unwarranted spilling of blood and wrecking of property," he wrote.

Jihad had to be authorised by a qualified imam or sheikh, he said, not the "heroes of the internet". He approved of *jihad* in Afghanistan and had mixed feelings about Iraq. But the September 11th attacks, he thought, were "a catastrophe for Muslims...What good is it if you destroy one of your enemy's buildings and he destroys one of your countries?"

Perhaps in response to such criticism, al-Qaeda's propaganda has gone into overdrive. Mr Zawahiri wrote a rebuttal of nearly 200 pages accusing Dr Fadl of seeking American-style "Islam without *jihad*". The reclusive Mr bin Laden has become more active, delivering four audio speeches this year, mostly on the crowd-pleasing theme of Palestine.

Al-Qaeda may have thought that, by goading America into invading Muslim lands, it would engineer a popular *jihad* against the "far" enemy. In part it succeeded. But it also discovered that fighting in Muslim lands means having to deal with a growing number of "near" enemies, be they fragile new governments, rival religious sects or tribes that have become fed up with the extremists.

Do al-Qaeda's setbacks answer Donald Rumsfeld's question about whether America is winning or losing the "war on terror"? Not really. The best that can be said is that America has stopped losing but is not yet winning it.

The idea lives on

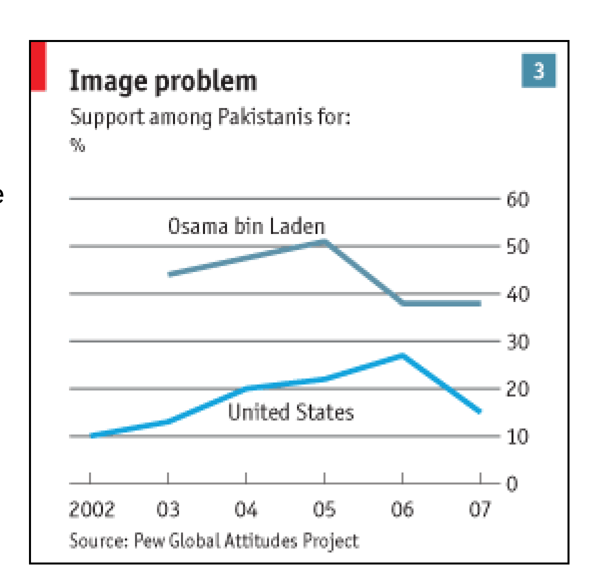
Al-Qaeda is both an organisation and an idea. As an organisation it is weaker than it was when it had the run of Afghanistan, but stronger than it was immediately after the toppling of the Taliban in 2001. The loss of senior figures, the hardening of international borders and better intelligence co-operation across the world have helped to contain it. But it may yet enjoy a resurgence if Pakistan's new government gives up trying to control the country's tribal belt.

What of al-Qaeda as an idea? Some argue that its support base nowadays is less of an ideological movement and more of a youth cult, based on anger and the desire to emulate the fighters on internet video clips. Perhaps so. It is ideology, however, that convinces young Muslim men in northern England to define themselves as Muslim rather than British, and that drives Muslims to blow themselves up in the name of God.

The backlash, particularly from former supporters, is hurting the global jihadists. But it is unlikely to put an end to their violence for the foreseeable future. Jihadists will dismiss criticism as the product of coercion or selling out to local rulers.

Al-Qaeda was never going to be a mass movement. It takes only a small cadre of dedicated terrorists to wreak havoc, particularly if havens are available. In any case, Mr bin Laden retains a sizeable core of support in several countries, and Western mistakes could easily boost that.

Perhaps the more important opinion polls are those that gauge America's (un)popularity. The Pew survey, for instance, found that America's standing in the Muslim world was "abysmal"; in Pakistan it was much lower than Mr bin Laden's (see chart 3). America's overt military presence in Iraq and Afghanistan may be necessary to avoid a vacuum, but it will feed Muslims' sense of grievance and encourage violent extremists.



Al-Qaeda will not be defeated by America but rather by governments in the Muslim world that manage to extend their writ across its lawless areas. This will take time, Western assistance and much diplomatic skill. Until then the West will have to co-operate with other countries (sometimes holding its nose) to contain the threat—and hope that the jihadists continue to wreck their own cause.

Sources and acknowledgments

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Aviation

Crisis? What crisis?

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The airlines are suffering, but the order books of Boeing and Airbus are bulging

Reuters



IT IS usually axiomatic that when your customers are in trouble, you are too. But at this week's biennial Farnborough airshow, the aviation industry's biggest bash this year, that was not how it looked. With the exception of a few airlines from the Middle East, for which high oil prices are helping to fund an expansion, airlines are in deep trouble. According to IATA, their trade association, if fuel costs stay at present levels, the world's airlines will lose over $6 billion this year.

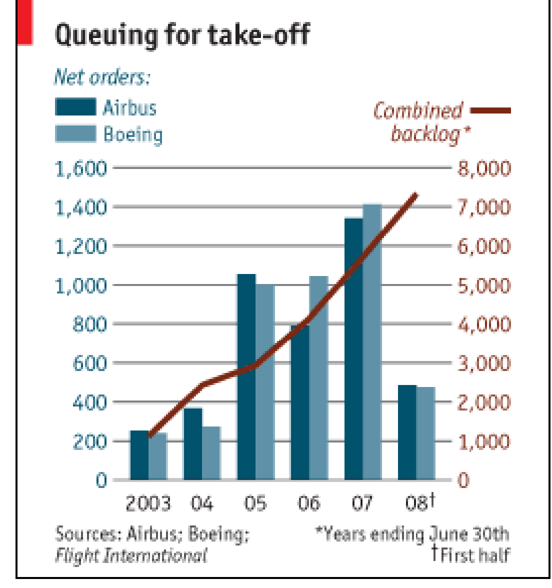
The pain is greatest in America where competition is fierce, many planes are old and fuel has to be bought with weak dollars. But just about everybody is hurting. Martin Broughton, the chairman of British Airways, said this week that the airline was "up to its neck in perhaps the biggest crisis the aviation industry has ever known" and was responding by cutting flights. Even Cathay Pacific, one of the most efficient operators in the hitherto booming Asia-Pacific market, issued a profit warning on July 2nd. A number of Indian carriers also look vulnerable.

Yet despite the mounting crisis within the airline business, the mood at Boeing and Airbus, the two firms that own the market for large commercial aircraft, is oddly sanguine. During past downturns in what has always been a highly cyclical industry, the planemakers have suffered along with their customers. But this time, they think it might be different.

One reason is that both still have bulging order books with production backlogs that will take years to work through (see chart). Boeing's head of commercial aircraft, Scott Carson, predicted this week that new orders would continue to outstrip production, so that its $271 billion backlog, the largest in its history, will continue to grow. The same is true of Airbus. Its total order backlog is more than 3,700 planes, the equivalent of about six years' production. Its chief salesman, John Leahy, was hoping to end the week with another 200 orders in his pocket.

Both Boeing and Airbus insist that so far there have been virtually no cancellations. Airbus is even planning a 15% increase in production by 2010, though it says it is now reviewing that decision. Mr Leahy admits he has been calling customers to sound them out. "I don't want to build a plane next year they don't want," he says. But his bleakest scenario is that the airlines' woes could cut the backlog by 27%, which would still not affect production for several years.

One reason the planemakers are bullish is that neither is dependent on the hard-hit American market. “We’re fortunate because, unlike in other cycles, only 10% of our backlog is in America,” says Boeing’s chief executive, Jim McNerney. Another reason is that demand for new, more fuel-efficient aircraft has never been greater. The latest versions of the Airbus A320 and Boeing 737, the single-aisle workhorses for which demand is strongest, are up to 40% cheaper to run than the vintage planes some American airlines still use.



But the airlines want more from Boeing and Airbus. Although the current version of the 737 is only ten years old, it was designed to catch up with the now 20-year-old A320. And despite the industry’s boasts about technical progress, a new A320 delivered next year will be only marginally more efficient than one delivered in 1988. That is worrying for early A320 customers, such as Air France-KLM, which would normally expect to see a double-digit gain in operating-costs when it replaces a 20-year-old plane. Even the Americans, who are desperate to get rid of their old gas-guzzlers, are worried that they will be buying old technology.

Unfortunately for the airlines, Airbus and Boeing have recently confirmed that the date for producing successors to their single-aisle planes is receding. A year ago, the new aircraft looked as if they might enter service in 2015. Now, both are saying that 2018 is more likely, at the earliest—and their reasons for delay are almost identical.

First, there are those fat order books. As of July 1st, Airbus had an order backlog of 2,634 A320-class planes, and Boeing’s backlog of 737s was 2,243. Why replace an aircraft that you cannot make fast enough? Second, both Boeing and Airbus are having their financial and engineering resources stretched by other projects, which are also important to the airlines. For Airbus, the priority is to ensure that its larger A350 is delivered on time in 2013. Boeing has little spare capacity for anything other than getting the badly delayed 787 flying and into the hands of impatient customers as quickly as possible. Even when it manages that, it may decide to concentrate on updating the 777, which will be threatened by the 350-seat A350-1000, due in 2015.

The third reason is that neither manufacturer believes that the advances in technology have yet been made to justify the expense of developing a new narrowbody. Airbus talks about a “technology pot” that is still only “half full”; Mr Leahy says that they are “waiting for the engine guys to wow us.” Mr McNerney adds that the airlines want a 15% efficiency improvement over the very advanced 787—something that they cannot yet accomplish. Philippe Jarry, head of market development at Airbus, claims that airlines “could get a 15% efficiency gain tomorrow” if they ended their “frequency frenzy” by operating fewer flights. “We refuse to carry on our shoulders the misery of the industry,” he says.

Is the duopoly getting just a bit cosy? One new aircraft that was announced at Farnborough was the Bombardier CSeries, a 110- to 130-seat jet that will enter service with Lufthansa in 2013 and will compete with the smallest versions of the A320 and 737. With a fully composite wing and Pratt & Whitney’s new geared-turbofan engine, the CSeries should cut operating costs by 15% compared with similar-sized aircraft. Boeing and Airbus will have to decide whether they are willing to cede a small but important slice of the market to the Canadian interloper. The airlines will be hoping it is just the wake-up call they need.

Continental and Schaeffler

With cat-like tread

Jul 17th 2008 | FRANKFURT
From The Economist print edition

A German car-parts supplier stalks its much bigger rival

TWO years ago Continental AG, one of the world's big tyremakers, saw off a consortium of big-name private-equity investors without any difficulty. But now it may be taken over by a local rival just a third of its size. On July 15th Schaeffler, a privately owned maker of bearings, surprised the markets when it announced its intention to buy a controlling stake in Continental. The €11.2 billion ($17.8 billion) unsolicited bid would create the world's biggest car-parts firm by sales.

In 2006 Conti's shark repellent was a high share-price and a buoyant market for tyres, brakes and car electronics. Yet the world has changed, and the firm's share price has since plunged. Last year Conti paid €11 billion for VDO, an electronics specialist, but the integration has been slow and the debt costly. Some of its markets, such as winter tyres, a Conti speciality, are shrinking. The three car giants in North America, where Conti looks for over a fifth of its turnover, are teetering: General Motors announced another round of factory closures and job cuts this week. High raw-materials prices and the strong euro are making life hard for German exporters.

Schaeffler saw a chance to think even bigger than it did in 2001, when it bagged FAG Kugelfischer, a rival bearing-maker, in a hostile takeover, for €730m. In the past few months Schaeffler has built a 2.97% stake in Conti, just avoiding the need to make a stock-exchange announcement, and has supplemented this with share options and cash-settled share swaps with banks, giving it the potential to secure 36% of the firm at a fixed price. This week the target seemed powerless to prevent a loss of control, though it protested to BaFin, the financial watchdog, that the tactics were illegal. BaFin's scrutiny seems unlikely to stall a deal. Although Conti shares climbed to €74.55, neither does a rising share price.

Does the deal make sense? Industry experts, recovering from the shock, say it would. Conti's VDO division is working on the next generation of electrically powered cars and Schaeffler needs to grow and diversify into electronics if it is to keep up with developments in the car industry. For Conti, which has clashed with unions and shareholders over its strategy in the past, going private could give it more elbow-room. Robert Bosch, its bigger German rival, is family-run. Porsche (which employed some very similar takeover tactics with Volkswagen, ten times its size, that seem to have inspired Schaeffler) appears to benefit from tight family control. And the cultures of Conti and Schaeffler look compatible. Hubertus von Grünberg, Conti's chairman, used to sit on Schaeffler's advisory board.

Schaeffler's approach continues to be stealthy. It wants more than 30% but "not necessarily a majority stake", its announcement said. It would make a full takeover offer—which it was obliged to do—but at the lowest price permitted by the takeover rules, discouraging potential sellers. It moved to allay fears that it plans to break up Conti, delist it from the stock exchange or cut jobs. It also supported the firm's strategy "including its tyre business", said Jürgen Geissinger, Schaeffler's chief executive.

That is where Schaeffler and some industry experts disagree. "Spinning off Conti's world-famous tyre brand to an Asian buyer would go a long way towards paying for what Schaeffler really wants—the electronics," says one analyst. But Maria-Elisabeth Schaeffler, the controlling voice in the family firm, could well defy industrial logic to give Conti and its staff a gentler ride. Her intervention reportedly won hearts and minds when Schaeffler bought FAG Kugelfischer.

Business in China

Busting trust

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The land of the mega-monopoly is about to adopt an antitrust law

IT TOOK more time than the Long March and the Great Leap Forward combined, but after 14 years of wrangling China will introduce a comprehensive antitrust law on August 1st. It could prove to be hugely important: it has been called China's "economic constitution". The law would give China's economy a further big push from central planning and state ownership towards markets, says Lester Ross of the Beijing office of WilmerHale, a law firm.

On the face of it, the law is desperately needed: energy, telecoms, transport, steel and many other industries lack competition, with a handful of dominant firms controlling prices not only for consumers, but for other companies too. Even fragmented industries, such as rice flour and instant noodles, where competition ought to abound, were recently reported to have seen price-fixing and collusion organised through the trade groups that are a legacy of the state-controlled economy.

At the moment competition is governed by a set of regulations from 2006, along with three other laws—the Anti-Unfair Competition Law, the Price Law and the Consumer Rights and Interests Protection Law. These various rules are scattered throughout China's bureaucracy, and are universally condemned as toothless and lacking clarity. The new competition law reflects a belief by many in the Chinese government that the economic restructuring that began with the death of Mao can go forward only if consumers benefit from the lower prices and higher quality that competition produces.

Matched against this belief are more cynical and protectionist forces that have, alas, had a strong hand in shaping the new law. Many of the big Chinese monopolies are owned in part or whole by the state itself. One of the causes of the new law's delay was the debate over whether these firms, which comprise a huge chunk of China's economy, should be covered by it. After a series of drafts included and then excluded state-owned monopolies, a compromise was reached. The law applies to them, but with an exemption when economic or national security is threatened—a loophole almost as big as China itself.

Worse is a suspicion that rather than going after the big monopolies, the law's initial targets will be foreign companies. Taking a lead from the European Union, China will start reviewing mergers of companies, regardless of where they are based, so long as they operate within its borders or affect companies that do. Regulators will consider the effect on "the progress of technology" and "national economic development". At the very least, this means large mergers must be blessed by the Chinese authorities, which will have a minimum of 30 days to assess them—and will be able to extend their review to 180 days. International law firms may be celebrating, but other companies must be lamenting that they will now face frictional costs to mergers in Beijing, as well as in Brussels and Washington, DC.

The law may also conflict with intellectual-property rights. Chinese manufacturers in many industries have long bridled at being forced to cut their own production costs to retain sales, even as they have to pay what seem like large royalties to patent holders (as in the production of DVD players, for example). In industries such as software and pharmaceuticals, where the market is dominated by just a few foreign companies, the law may also justify litigation based on a superficial definition of dominance. It then allows prosecution over royalty rates, or restrictions on licensing. It is not hard to see how the law could be used to legitimise expropriation.

Worryingly, with only weeks before the law comes into effect, it has not yet been announced who will oversee it. The delay is a product of the competition within China's bureaucracy, as rival agencies compete for such a valuable prize. One theory is that the job will be divided between three agencies. The winners will not only gain power within the national bureaucracy, but will be able to disrupt lucrative local monopolies that are often controlled by regional politicians. The new law could, in short, influence not just how business is run, but also how it is locally regulated.

Internet piracy

Thanks, me hearties

Jul 17th 2008
From The Economist print edition

Media firms find that statistics on internet piracy can be rather useful

Illustration by David Simonds



GLOBAL sales of recorded music fell by 8% in 2007, according to figures released in June by the International Federation of the Phonographic Industry, a trade group. It blamed 70% of the decline on "file-sharing" software, which allows internet users to exchange music and video without paying for it. Industry groups have sued thousands of users of such software, and have supported legislation to criminalise it. But file-sharing has so far proved impossible to stop. And it is not all bad news for the industry, because it can provide helpful insights into music-lovers' interests.

For every song that is bought legally, in shops or online, around 20 songs are illegally downloaded, according to BigChampagne, a firm based in Beverly Hills, California, that compiles and sells statistics about file-sharing. Its customers can find out how many times, and where, a song has been illicitly downloaded, for example, what the figure was five weeks ago, what other music its fans like, and so on.

"It doesn't make sense to put your head in the sand," says Ken Bunt, head of marketing at Disney's Hollywood Records, a BigChampagne customer. One of Hollywood Records' artists, Jesse McCartney, is particularly popular in Italy, so that might be a good place for a tour, says Mr Bunt.

David Ross, the editor of *Music Row*, the largest country-music trade journal, based in Nashville, Tennessee, says the "anti-intellectual argument" not to use such data is emotional nonsense. *Music Row* publishes file-sharing figures, as well as conventional charts. Such information can help managers promote their artists. Jennifer Bird of Red Light Management, a management agency in Los Angeles, says her agency knows the names and geographic destinations of the 7.5 billion songs swapped in 2007. That is a big help if you are trying to work out whether people are raving about an artist—or merely about a song. And planning joint tours is easier when you know what other music an artist's fans listen to.

BigChampagne's latest venture, launched this month, extends its monitoring to television programmes and films, which are also widely shared online. Knowing what is popular among file-sharers could help broadcasters and film studios when negotiating with advertisers, for example. Hulu, a website operated by News Corporation that offers free, advertising-supported video-streaming, already uses file-sharing statistics to design its programming and to set advertising rates.

Many music executives were reluctant to take advantage of file-sharing statistics because of the trouble the technology has caused in the industry, says Eric Garland, BigChampagne's boss. TV stations and film studios, by contrast, are "sprinting through the stages of grief"—and coming to terms with the reality that details of the illegal use of their material can, in fact, be very useful indeed.

Business in France

Jobs for the old

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France's negative attitude to older workers creates a business opportunity

IN 2007 a French food company wanted to buy a family-owned firm in India. The patriarch was 72, and the French firm wanted to send someone of similar experience to talk to him. But because of its youthful corporate culture—most people are hustled out of the door in their mid-40s—it had no one to send. In the end, through Experconnect, an employment agency in Paris which places retired people, it found a 58-year-old former head of a European consumer-goods firm, and sent him out to Mumbai.

France has a poor record when it comes to keeping older people in the workforce. The retirement age is 60, not 65 as in most developed countries. In 2005 only 37.8% of people aged 55-64 had jobs, versus 56.8% in Britain and 44.9% in Germany. The main reason is that in the 1980s, when there was high unemployment, the government promoted early retirement. That entrenched the idea that older workers were less productive, says Caroline Young, Experconnect's founder.

Now companies are worried about losing their most skilled workers, especially as the baby-boom generation nears retirement. Areva, a nuclear-power group, recently launched a scheme to address the needs of older employees, and plans to use about 100 retired people a year through Experconnect. Because nuclear power was unpopular for decades, Areva stopped training engineers, so that much of its expertise lies with its oldest staff. Now it is taking much more interest in them. "We have to bring about a revolution in opinion," says Jean Cassingena, its human-resources strategist.

Unlike other recruitment agencies, Experconnect keeps its workers on its own books, so they can carry on drawing their pensions. They tend to work part-time on one-off projects. Engineers and people with high levels of technical skill are most in demand in France, says Ms Young, as younger people increasingly choose to go into fields such as marketing. Thales, a defence and aerospace firm, is using a former radar expert, for instance, and Louis Berger France, an engineering firm, often uses retired engineers to manage big infrastructure projects.

Softer industries also make use of Experconnect. Danone, a food firm, hires people for one-off management roles. "Older people have seen it all and they are level-headed," says Thomas Kunz, its head of beverages. The beauty industry is short of toxicologists to determine whether new lotions are safe, and one firm has just taken on a 75-year-old. Two famous French luxury-goods companies plan to use retired workers in their handbag divisions. One wants to safeguard its knowledge of fine leathers and sewing; the other wants to apply expertise from the aerospace industry to make new kinds of materials for handbags.

Despite an impressive handful of high-profile clients, Experconnect has found it difficult to convince French companies that older workers can be valuable. It has 2,700 retired people on its books, and has so far placed just 50 of them on "missions". Old prejudices, as they say, die hard.

Wireless telecoms

Culture clash

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From The Economist print edition

As “third generation” (3G) networks proliferate, the focus shifts to 4G

WHAT would the technology industry be without standards wars? Like a city without sex, some might argue. But not all fights are winner-take-all battles like the one between VHS and Betamax in videotapes, or Blu-ray and HD DVD in high-definition video discs. Sometimes there need not be a loser, and the din of battle may drown out the real issues—as in the fight between WiMAX and LTE.

These are the main contenders for the next generation of wireless networks, known as “fourth generation” (4G) networks. Many equipment-makers are already working on 4G technology, even though consumers in many countries have yet to experience the 3G sort. And hardly a week passes without news from the battlefront. This week ELRO, a Danish utility, awarded a contract for a nationwide WiMAX network in Denmark; and Verizon Wireless, an American operator, said it would launch an LTE network in 2010.

Both 4G technologies promise wireless nirvana: fast, ubiquitous broadband. Once radio chips are cheap enough, they will crop up not just in handsets and laptops, but in devices such as digital cameras and electricity meters, which are unconnected today. But the telecoms and computer industries have very different ideas about how this should be done, and this explains the split between WiMAX and LTE (which are technically similar). WiMAX is an attempt by the computer industry to export its way of doing things to the telecoms industry—and LTE is the response.

WiMAX’s main cheerleader is Intel, the world’s biggest chipmaker, which wants to remain dominant as computing goes mobile. Since 2002 it has rounded up a coalition of firms, each with its own interest in seeing WiMAX succeed. Google, for instance, wants to get online advertisements onto mobile devices. For Sprint Nextel, an embattled American wireless operator, it offers the chance of a comeback.

Intel’s vision, and that of its allies, is that wireless broadband should be as “open” as the internet. WiMAX devices need not be subsidised by operators and will be sold in retail stores. The intellectual property will be shared. Consumers will pay a flat fee for access, and can then use whatever online services they want. Commoditising the transport of data will, the WiMAX camp hopes, boost demand for Intel’s chips, Google’s services and so on.

What Intel is to WiMAX, Ericsson is to LTE, which stands for Long Term Evolution. As its name suggests, it is meant to be an update to today’s mobile-network technology. This makes it attractive not just to Ericsson, the world’s biggest maker of such gear, but also to other vendors and to most mobile operators: they can build on their existing investments. Another member of the LTE camp is Qualcomm, an American chipmaker that owns vital chunks of intellectual property in wireless telecoms.

Like the WiMAX alliance, the LTE camp stands for a certain way of carving up the pie, which critics call “closed” because it may limit consumers’ choice. Operators, they worry, will control which devices can connect to their networks and will try to keep users within a “walled garden” of services, as they do today, in an effort to capture more of their users’ online spending.

Until last autumn, WiMAX seemed to have a lot of momentum. Its standards had been agreed on, equipment-makers were already making the gear and some 300 operators across the world were building networks (albeit mostly of the “fixed wireless” kind, where the wireless link is a substitute for a tethered broadband connection). In America Sprint and Clearwire, a wireless start-up, had started building nationwide WiMAX networks. WiMAX, it seemed, was ready to go, whereas LTE was still under development.

But since then the tide has turned. Sprint and Clearwire ran into financial and technical problems. Other operators reported that the technology was not ready for prime time. Auctions of radio spectrum suitable for WiMAX have been delayed. And the LTE camp has fought back. Its technology recently received the

official backing of the influential GSM Association, a global club of wireless operators. And Verizon and AT&T, America's largest operators, said they would adopt LTE.

Now everybody seems to think that WiMAX will be no more than a "niche technology", in the somewhat self-serving words of Hakan Eriksson, Ericsson's chief technology officer. Frost & Sullivan, a market-research firm, predicts that if spectrum auctions and commercial roll-outs do not happen this year, "the market scope for mobile WiMAX on a global basis will be insignificant." Nortel, another big equipment-maker and an early WiMAX backer, estimates that its market share will be 10% at best by the end of 2012, and recently said that it would now focus on LTE.

It would be wrong, however, to count WiMAX out just yet. It will find a place in developing countries, where today's wireless technologies are less entrenched. Tata Communications, an Indian firm, for instance, intends to build the world's largest WiMAX network. And Intel and its allies still seem willing to spend heavily to jump-start the technology. Intel's venture-capital arm has invested in WiMAX firms around the world and will continue to do so, says Siavash Alamouti, one of Intel's WiMAX evangelists. Intel, Google and three American cable operators are investing $3.2 billion in Clearwire, which is merging with Sprint's WiMAX operation, called Xohm.

The new entity, still called Clearwire but majority-owned by Sprint, has about two years to prove the value of WiMAX, says Peter Jarich of Current Analysis, another market-research firm. This will be hard. Clearwire hopes to launch in September in Baltimore, but further delays would not come as a surprise. In the meantime, operators are upgrading their 3G networks to reach similar access speeds.

Yet even if Clearwire fails and WiMAX is confined to a niche, the efforts of Intel and its allies will not have been in vain. The LTE camp has already taken more than one leaf from WiMAX's book, says Olivier Baujard, chief technologist at Alcatel-Lucent, another big equipment-maker, which has a foot in both camps. The first LTE networks will now be deployed much faster than expected, perhaps as soon as 2009. Makers of LTE gear have also agreed to fair cross-licensing of intellectual property (although, predictably, Qualcomm has refused to join either patent club). And mobile operators appear to have realised that they need to open up their networks.

This rapprochement may explain why there is now talk of merging the two technologies, by making WiMAX part of the LTE standard. Even Sean Maloney, Intel's Mr WiMAX, says "they ought to be harmonised". Although this is still unlikely, it would not be a bad outcome. Subscribers could then take advantage of internet-like openness combined with the robustness of wireless technology—without having to put up with the inconvenience of two different standards.



Low-cost telecoms

Yabba Dabba do

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How to build a local phone network

DIGITAL technology may seem unpredictable, but it follows some basic patterns. Innovations quickly become commodities, enable arbitrage and lead to more distributed systems. Combining all three is the recipe for Dabba, a South African wireless start-up, which has pioneered an idea called the “village telco”. It could make phone calls much more affordable for many people.

First, Rael Lissoos, Dabba’s founder and a socially minded entrepreneur, uses the cheapest technology he can find to build a wireless network. Reprogrammed Wi-Fi routers serve as base-stations. Open-source software weaves them into a network. Cheap Wi-Fi handsets can then make calls. Dabba offers free local calls to the people of Orange Farm, a township near Johannesburg where it has built its first network.

Second, Mr Lissoos bases his business model on arbitrage. Benefiting from vague language in South Africa’s telecoms regulations, he connected his local network to the national network. Dabba buys phone minutes in bulk and sells them in the form of pay-as-you-go cards. Because South Africa’s retail phone rates are high, it is easy for Dabba to underbid other operators and still make a profit. It also makes money from termination fees when its subscribers receive calls from outside Dabba’s network.

Third, Mr Lissoos wants his firm to be the model for other “village telcos”, and to use its technology. Local entrepreneurs, he hopes, will build their own networks and use Dabba as a gateway to the public phone system. He has teamed up with Cisco, a network equipment-maker, to offer training classes. The idea is to create a decentralised network of networks, a bit like the internet. “Wireless networks have traditionally been created top-down,” explains Mr Lissoos. “We want to do it bottom-up.”

So far, only 50 phones are connected to Dabba’s network in Orange Farm. The firm must now prove that its model can attract subscribers and be repeated elsewhere. Two organisations have signed up to help. The new African fund of Hasso Plattner Ventures, a German venture-capital firm, is making an investment. And the Shuttleworth Foundation, a geeky South African charity, has earmarked money to make the technology easier to use. If the concept takes off, says Mr Lissoos, village telcos might also pop up in rich countries.

Marathon man

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From The Economist print edition

Can Tom Enders, the chief executive of Airbus, turn the planemaker into a "normal" company?

Reuters



"I KNEW this was not going to be a sprint, but a marathon," says Thomas Enders as he looks back on his first year as chief executive of Airbus—the firm that, with Boeing, holds a duopoly in the market for large civil aircraft. The emphasis Mr Enders puts on the long haul is calculated. When he took over, he was the fourth chief executive in little more than a year—a reflection of both the crisis that engulfed Airbus in June 2006 and the political in-fighting that had contributed to it. A former Bundeswehr paratrooper, Mr Enders is a fitness fanatic who climbs mountains, still enjoys the occasional parachute jump and likes to run half-marathons. So when he was given the chance to run Airbus, he says, he was sure he had the stamina and energy to go the full distance.

This week, at the biennial Farnborough Air Show, the aviation industry had the chance to judge whether Mr Enders has the right stuff to give the planemaker the stability and strategic clarity it desperately needs. Some progress has already been made: for proof, note that Mr Enders is the sole chief executive at Airbus and reports to just one superior, Louis Gallois, the chairman of Airbus's parent, the European Aeronautics Defence and Space company, or EADS. (EADS used to be lumbered with a dual-management structure, a legacy of its origin as a Franco-German joint venture.) But Mr Enders admits that much more must be done if he is to turn the technologically brilliant but politically dysfunctional firm into what he calls a "normal company".

It was two years ago that the old Airbus finally ran out of runway. Plagued by power struggles within the core group of EADS shareholders as well as its bizarre governance, Airbus suffered when it admitted that deliveries of its new superjumbo, the A380, would be severely delayed. Shares in EADS tanked. The immediate cause was problems wiring up the huge aircraft, brought on by the use of incompatible software in the firm's French and German factories. But the underlying reason for the mess was a hopeless lack of integration within the company.

A month later, at the 2006 Farnborough Air Show, a new chief executive, Christian Streiff, confirmed just how bad things were. Airlines that had ordered the A380 would be lucky to get their planes two years late. Almost as embarrassing, Airbus also had to admit that customers had not been impressed with its proposed A350, a competitor for the fast-selling Boeing 787 Dreamliner. Mr Streiff promised a bigger, more technically advanced aircraft (with a much higher share of weight-saving composite materials in the airframe), but the return to the drawing board meant that the new A350 XWB would be five years behind the 787.

Mr Streiff lasted a hundred days, quitting after he concluded that the politicised EADS board would

interfere with his own radical cost-cutting programme, known as Power8. After Mr Streiff's stormy exit, the sophisticated and emollient Mr Gallois held the fort for several months before Mr Enders was finally appointed. Some saw it as a demotion, because he was stepping down as co-chief executive of the parent company. But Mr Enders disagrees. “It was the first time in my life that I was really prepared to fight to get a job,” he says. “I wanted it so much.” Because Airbus generates over two-thirds of EADS' revenues, Mr Enders reasoned that the greatest contribution he could make was to help dig the firm out of the pit it had dug for itself.

The situation he inherited was, to put it mildly, mixed. On the one hand, a year of booming sales resulted in an order backlog by the end of 2007 of 3,421 aircraft—a 50% share of all large aircraft yet to be delivered. Deliveries of the A380 were about to begin and the revised A350, increasingly seen as a more of rival to Boeing's 777 than the smaller 787, was gaining traction with customers. The Power8 restructuring plan, which included selling some factories in Europe to suppliers, was proceeding slowly, but with less union resistance than had been feared. On the other hand, there was no end in sight to the weakness of the dollar, the currency used to price commercial aircraft, which has become, Mr Enders says, “life-threatening” for Airbus.

And there have since been other setbacks. The European factory-disposal plan has been stalled by the credit crunch, while unpleasantness of a different kind is taking its toll on morale. Last October it emerged that 17 past and present senior executives, including Mr Enders, were being investigated by the French authorities for selling shares in late 2005, seven months before news of the A380's production delays emerged. They all deny any foreknowledge of the seriousness of the problems. This week Mr Enders described the investigation as “a show trial and a piece of bad theatre”.

Soaring above it all

Mr Enders is adamant that nothing will deflect him from the task in hand, which is “to drive this company as far and as fast as possible in the direction of being a normal company. Aerospace is a political and strategic industry, but we need to make as much room as possible for business thinking and entrepreneurial decisions.” In practice, he says, that means both fixing the integration woes that beset the A380 and internationalising the company. “We will not survive as a non-integrated political plaything, and we will not survive as a mainly European company,” he adds.

Paradoxically, Mr Enders is himself a product of the nexus between politics and aerospace. Over his career he has moved seamlessly between academia, high-powered research institutes, politics and business. “Politics is structured chaos,” he says. “The political realm is not regulated by processes and manuals.” Unlike his fellow German colleagues, most of whom had backgrounds in engineering or accounting, Mr Enders admits he quite enjoyed playing the political game at EADS, though he now sees it as destructive. However, it is precisely because of what he calls his “political fingertips” that Mr Enders thinks he is the man to get the politics out of Airbus—or, at least, to keep it at bay.

World trade

Defrosting Doha

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From The Economist print edition

AFP



Within a week the Doha round of trade talks could be ready to serve or left to rot

FROM hope to acrimony; from acrimony to apathy; and now back towards hope again: the Doha round of world trade talks has almost come full circle. Launching the round in Qatar's capital city in November 2001, as the world reeled from terrorist outrages and the dotcom bust, trade ministers declared their determination to liberalise trade so that "the system plays its full part in promoting recovery, growth and development." By 2003 the hope had gone: a ministerial meeting in Cancún, a Mexican resort, broke up early amid angry recriminations. Two years ago progress was so feeble that Pascal Lamy, director-general of the World Trade Organisation (WTO), suspended negotiations.

Many wrote the round off at that point. Yet for the past year or so trade negotiators in Geneva have been chiselling away at the areas of disagreement. They have sculpted enough, Mr Lamy believes, for him to gather a group of around 40 ministers at the WTO's lakeside headquarters to try to shape a deal. Their deliberations, which are due to last a week, begin on July 21st. Success would mean that a conclusion to the round the world forgot could at last be contemplated. At the core of an agreement would be cuts in allowable subsidies to farmers and lower tariff ceilings for both agricultural and industrial goods.

Mr Lamy's invitation is something of a gamble, but he attaches great importance to reaching agreement in 2008. Early in the year, some trade officials hoped for a ministerial meeting in April, then the talk turned to May, then June. Mr Lamy could not have left it much later. The timetable is getting tight. European officialdom is about to enter its summer lull, India's minority government is in a precarious position and America's presidential and congressional elections are looming.

Details, details

Even if ministers reach agreement in Geneva, officials will still have lots to sort out. The deal's basic formulae will have to be converted into tariff schedules for thousands of products, controversial rules on anti-dumping must be thrashed out, and the services negotiations must catch up. And success is far from guaranteed. Talks have centred on two main areas: trade in farm goods and industrial products (non-agricultural market access, or NAMA, in WTO jargon). The ambassadors who chair the WTO's agriculture and NAMA negotiations have smoothed out a lot of rough areas, but would still have liked to leave ministers with less work to do. Talks on NAMA have continued this week.

Broadly speaking, Europe and India are under attack for wanting to spare too many farm products from deeper tariff cuts; some developing countries are being asked to reduce industrial tariffs further and faster; and America is under pressure to do more to cap trade-distorting subsidies to its farmers.

This last issue, in particular, could be a deal-breaker. India's commerce minister, Kamal Nath, wants America to cap its farm spending at last year's total minus one dollar. The draft agreement suggests limits much higher than this ($13 billion-16.4 billion). That would do little to constrain America's potential spending, except perhaps on cotton and sugar.

The chief reason for urgency is to complete a deal before George Bush leaves office. This may seem curious, because he is in no position to get a Doha deal through Congress. He lacks "trade promotion authority" (TPA)—the right to negotiate a trade agreement and present a bill to lawmakers for a straight yes-or-no vote without amendment—and will not get it now. Congress is in no mood to give it to him, and time is running out.

The best hope instead is to pass a finished, or nearly finished, agreement on to John McCain or Barack Obama. It is possible that the new president may dislike the deal so much that he seeks to renegotiate it or rejects it altogether. But renegotiation would be time-consuming at best, impossible at worst. Rejection would wreck the WTO for years, perhaps for good.

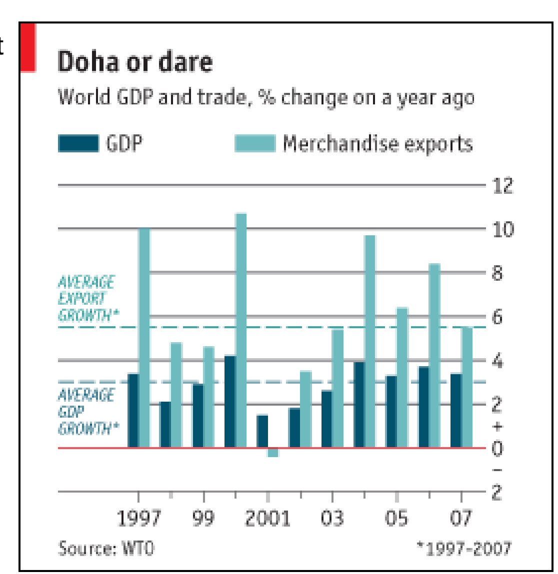
If he were to inherit a package that is complete or close to it, President McCain or President Obama would have something to press on the new Congress, perhaps after asking for TPA to wrap up the remaining details. He could even sell it as much-needed balm for an ailing global economy. Craig VanGrasstek, of the Kennedy School of Government at Harvard and *Washington Trade Report*, a newsletter, points to a precedent: when Bill Clinton took office in 1993, he asked Congress for a brief extension of fast-track authority, as TPA was then known, to complete the Uruguay round of world trade talks. Mr Clinton used this to get the round through in 1994 with relatively little fuss; he also secured the North American Free Trade Agreement (NAFTA), although with rather more.

But if Mr Bush leaves him with a lot of work still to finish, the new president may well conclude that he has better things to do. By 2010 such momentum as there is for a Doha round agreement may have been lost. "If it's not concluded this year, it won't be concluded next year and by 2010 the caravans will have moved on elsewhere," said Peter Mandelson, the European Union's trade commissioner, at the World Economic Forum in January. "Not only will the caravans have moved on in different directions of trade negotiations, but what has already been on the table...will have been put into deep freeze."

Back into the fridge

The consequences of putting the Doha round into cold storage come in two parts. The more nebulous, but arguably more important, is the long-term effect on the future of trade and the world economy.

You might suppose that it would not matter much. Despite all Doha's difficulties, world trade has been growing nicely without it (see chart). Developed countries' tariffs on industrial goods, at least, are already low. Developing countries have been opening up too, cutting tariffs to levels well below the ceilings negotiated at the WTO. Trade in services has been getting freer, although many countries' WTO commitments are still patchy. And countries have become much more welcoming to foreign investment, which the Doha round does not even address.



Look beyond the formalities of tariffs and investment agreements, to the nuts and bolts of modern commerce, and you may even conclude that it had become irreversibly integrated. Time was when almost every bit of a car, say, was made in one country, from the steel that formed its body to the leather on its seats. Now a supply chain of myriad links runs all around the world, connecting designers, chipmakers, car-parts firms and assembly lines.

Granted, if the Doha round fails, the world will not end. Nevertheless, it would be wrong—and complacent—to suppose that failure would be costless. For a start, the world economy is troubled. Doha

will not repair housing markets or ease credit constraints. But in difficult times calls for trade protection get louder, and may be heard favourably by politicians. This would be a bad moment, therefore, to turn away from further liberalisation. And the WTO as an institution would be damaged. The chances of another go at liberalisation soon, after an abject failure, would be slim.

Already there are some signs of rising hostility to trade. The plainest are the taxes or bans imposed by some countries on food exports in response to the rapid increase in prices. This is not protection as usually practised—in the Doha round, countries have been negotiating to end subsidies, not taxes, on farm exports. But had the negotiations been starting now, such gross impediments to trade might well have been on the agenda.

Another straw in the wind is the difficult progress of some regional trade agreements. Last year America's Congress passed a free-trade deal with Peru; this year it has stalled on one with Colombia. Any misgivings in Washington about an agreement with South Korea have been more than matched on the streets of Seoul, where thousands have protested against the prospect of American beef imports. Economists view bilateral and regional deals as a mixed blessing. But if hostility towards such agreements denotes unease about trade in general, it is a worrying sign.

And it is possible to imagine the world economy becoming less integrated. It has happened before: the fairly free world economy of the late 19th century was riddled with protectionism by the 1930s. Then, says Jeffry Frieden, a political scientist at Harvard, trading powers turned towards their empires; nowadays they would be more likely to turn towards regional blocks, such as the EU and NAFTA. An unwinding of globalisation, he thinks, is not likely but not implausible either. "The picture of an irreversibly integrated and globalised international economy is overdrawn," he says.

The second lot of costs is more direct. If there is no agreement, what will the WTO's members leave on the table? Measuring this is hard, partly because members of the WTO negotiate over "bound" (maximum) tariffs and ceilings on agricultural subsidies. Much of the deal would lower these ceilings rather than produce true cuts. For example, the latest text implies that Chile would cut its bound industrial duties from 25% to around 12%; its applied rate is only 6%. This is still worth doing because it limits backsliding.

Another reason is the sheer complexity of any likely deal. In NAMA, the basis of the draft text is a formula connecting new tariffs to old ones. But there are different parameters for developed and developing countries. Developing countries will be able to choose between shallower cuts across the board and exempting some goods from the formula in return for deeper cuts on the rest. Some have additional exceptions. In agriculture, there are similar complications. For instance, countries can declare some goods to be "sensitive" products. They will be permitted to cut their tariffs on these goods by less, in exchange for letting in larger amounts at lower rates of duty.

Even so, despite all the exemptions and wiggle room, the deal contains the promise of real liberalisation. Cuts in some bound tariffs will bite into applied rates too. The EU's duty on cars would come down from 10% to about 4.5%; its rate on canned tuna would tumble from 24% to about 6%. China's tariff on cars could come down from 25% to 18% even if it takes advantage of the exemptions to the NAMA formula.

Importantly for developing countries, tariff escalation—the levying of higher tariffs on processed goods than on raw materials—would be scaled back. Tariff escalation is, in effect, a tax on every step a country takes along the value chain. For instance, coffee that has been neither roasted nor decaffeinated enters the EU duty-free; decaffeinated and roasted, it incurs a tariff of 7.5%. Under the latest draft, the duty would be cut by half.

What does all this amount to? The WTO's staff reckon that consumers and firms will pay around $125 billion less in tariffs if a deal is struck. Yvan Decreux and Lionel Fontagné, of CEPII, a French economic research institute, have tried to measure the effect on global growth. They estimate that the world economy would eventually be $43 billion a year better off. Throw in some liberalisation of services too, and the sum rises by $30 billion.

Set against the scale of the world economy, these are not vast gains—around 0.1% of global GDP. But they are gains nonetheless, and they are probably an understatement: no one knows the value of the likely scale economies, productivity gains and extra variety that freer trade brings. Add to that the value of lowering bound tariffs and avoiding the institutional damage of failure, and the benefits do not look so puny after all. Will ministers grab them? Time to find out.

Fannie Mae and Freddie Mac

End of illusions

Jul 17th 2008
From The Economist print edition

Illustration by Bob Venables

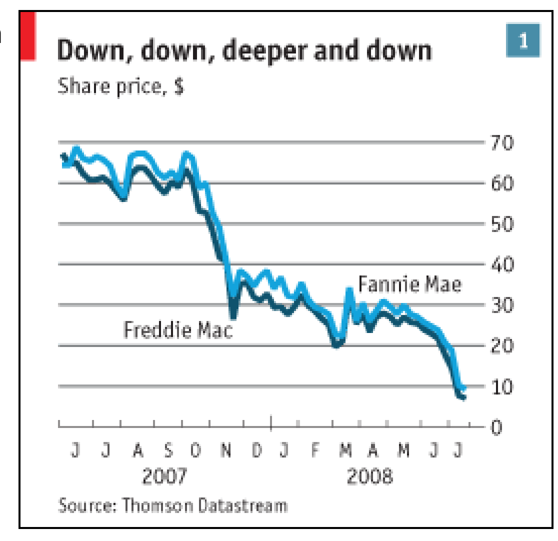


A series of articles on the crisis gripping the world economy and global markets starts where it all began—with America's deeply flawed system of housing finance

THERE is a story about a science professor giving a public lecture on the solar system. An elderly lady interrupts to claim that, contrary to his assertions about gravity, the world travels through the universe on the back of a giant turtle. "But what supports the turtle?" retorts the professor. "You can't trick me," says the woman. "It's turtles all the way down."

The American financial system has started to look as logical as "turtles all the way down" this week. Only six months ago, politicians were counting on Fannie Mae and Freddie Mac, the country's mortgage giants, to bolster the housing market by buying more mortgages. Now the rescuers themselves have needed rescuing.

After a headlong plunge in the two firms' share prices (see chart 1), Hank Paulson, the treasury secretary, felt obliged to make an emergency announcement on July 13th. He will seek Congress's approval for extending the Treasury's credit lines to the pair and even buying their shares if necessary. Separately, the Federal Reserve said Fannie and Freddie could get financing at its discount window, a privilege previously available only to banks.



The absurdity of this situation was highlighted by the way the discount window works. The Fed does not just accept any old assets as collateral; it wants assets that are "safe". As well as Treasury bonds, it is willing to accept paper issued by "government-sponsored enterprises" (GSEs). But the two most prominent GSEs are Fannie Mae and Freddie Mac. In theory, therefore, the two companies could issue their own debt and exchange it for loans from the government—the equivalent of having access to the printing press.

Absurd or not, the rescue package notched up one immediate success. Freddie Mac was able to raise $3 billion in short-term finance on July 14th. But the deal did little to help the share price of either company or indeed of banks, where sentiment was dented by the collapse of IndyMac, a mortgage lender (see article). The next day Moody's, a rating agency, downgraded both the financial strength and the preferred stock of Fannie and Freddie, making a capital-raising exercise look even more difficult. As a sign of its concern, the Securities and Exchange Commission, America's leading financial regulator, weighed in with

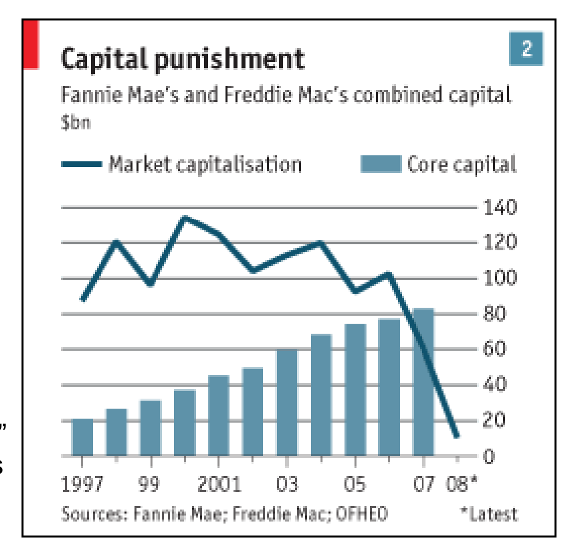
rules restricting the short-selling of shares in Fannie and Freddie.

The whole affair has raised questions about the giant twins. They were set up (see article) to provide liquidity for the housing market by buying mortgages from the banks. They repackaged these loans and used them as collateral for bonds called mortgage-backed securities; they guaranteed buyers of those securities against default.

This model was based on the ability of investors to see through one illusion and boosted by their willingness to believe in another. The illusion that investors saw through was the official line that debt issued by Fannie and Freddie was not backed by the government. No one believed this. Investors felt that the government would not let Fannie and Freddie fail; they have just been proved right.

The belief in the implicit government guarantee allowed the pair to borrow cheaply. This made their model work. They could earn more on the mortgages they bought than they paid to raise money in the markets. Had Fannie and Freddie been hedge funds, this strategy would have been known as a “carry trade”.

It also allowed Fannie and Freddie to operate with tiny amounts of capital. The two groups had core capital (as defined by their regulator) of $83.2 billion at the end of 2007 (see chart 2); this supported around $5.2 trillion of debt and guarantees, a gearing ratio of 65 to one. According to CreditSights, a research group, Fannie and Freddie were counterparties in $2.3 trillion-worth of derivative transactions, related to their hedging activities.



There is no way a private bank would be allowed to have such a highly geared balance sheet, nor would it qualify for the highest AAA credit rating. In a speech to Congress in 2004, Alan Greenspan, then the chairman of the Fed, said: “Without the expectation of government support in a crisis, such leverage would not be possible without a significantly higher cost of debt.” The likelihood of “extraordinary support” from the government is cited by Standard & Poor’s (S&P), a rating agency, in explaining its rating of the firms’ debt.

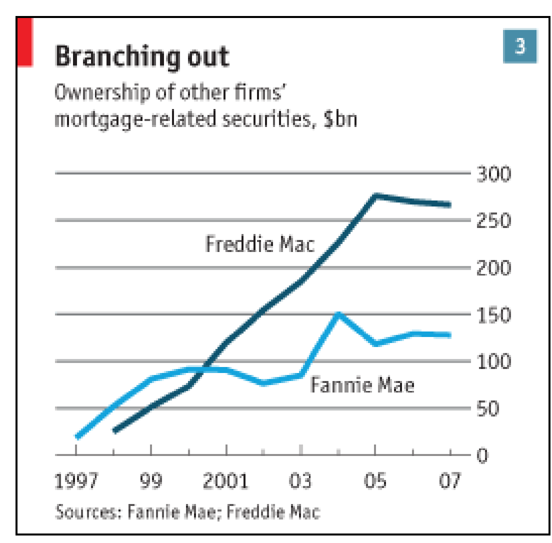
The illusion investors fell for was the idea that American house prices would not fall across the country. This bolstered the twins’ creditworthiness. Although the two organisations have suffered from regional busts in the past, house prices have not fallen nationally on an annual basis since Fannie was founded in 1938.

Investors have got quite a bit of protection against a housing bust because of the type of deals that Fannie and Freddie guaranteed. The duo focused on mortgages to borrowers with good credit scores and the wherewithal to put down a deposit. This was not subprime lending. Howard Shapiro, an analyst at Fox-Pitt, an investment bank, says the pair’s average loan-to-value ratio at the end of 2007 was 68%; in other words, they could survive a 30% fall in house prices. So far, declared losses on their core portfolios have indeed been small by the standards of many others; in 2008, they are likely to be between 0.1% and 0.2% of assets, according to S&P.

Of course, this strategy only raises another question. Why does America need government-sponsored bodies to back the type of mortgages that were most likely to be repaid? It looks as if their core business is a solution to a non-existent problem.

However, Fannie and Freddie did not stick to their knitting. In the late 1990s they moved heavily into another area: buying mortgage-backed securities issued by others (see chart 3). Again, this was a version of the carry trade: they used their cheap financing to buy higher-yielding assets. In 1998 Freddie owned $25 billion of other securities, according to a report by its regulator, the Office of Federal Housing Enterprise Oversight (OFHEO); by the end of 2007 it had $267 billion. Fannie’s outside portfolio grew from $18.5 billion in 1997 to $127.8 billion at the end of 2007. Although they tended to buy AAA-rated paper, that designation is not as reliable as it used to be, as the credit crunch has shown.

Sometimes the mortgage companies were buying each other's debt: turtles propping each other up. Although this boosted short-term profits, it did not seem to be part of the duo's original mission. As Mr Greenspan remarked, these purchases "do not appear needed to supply mortgage market liquidity or to enhance capital markets in the United States".



Joshua Rosner, an analyst at Graham Fisher, a research firm, who was one of the first to identify the problems in the mortgage market in early 2007, reckons Fannie and Freddie were buying 50% of all "private-label" mortgage-backed securities in some years—that is, those issued by conventional mortgage lenders. This left them exposed to the very subprime assets they were meant to avoid. Although that exposure was small compared with their portfolios, it could have a big impact because they have so little equity as a cushion.

Both companies make a distinction between losses on trading assets (which they take as a hit against profits) and on "available-for-sale" securities which they hold for the longer term and disregard, if they think the losses are temporary. At the end of 2007, according to OFHEO, Fannie had pre-tax losses of this type of $4.8 billion; Freddie's amounted to $15 billion.

The companies have also been unwilling to accept the pain of market prices in acknowledging delinquent loans. When borrowers fail to keep up payments on mortgages in the pool that supports asset-backed loans, Fannie and Freddie must buy back the loan. But that requires an immediate write-off at a time when the market prices of asset-backed loans are depressed. Instead, the twins sometimes pay the interest into the pool to keep the loans afloat. In Mr Rosner's view, this merely pushes the losses into the future.

Adding to the complexity is the need for both Fannie and Freddie to insure their portfolios against interest-rate risk—in particular, the danger that borrowers may pay back their loans early, if interest rates fall, leaving the companies with money to reinvest at a lower rate. This risk caused the duo to take huge positions in the derivatives market, and was at the centre of an accounting scandal earlier this decade.

In addition, Fannie and Freddie have bought insurance against borrower defaults when the homebuyer lacks a 20% deposit. But the finances of the mortgage insurers do not look that healthy, which may mean the risk ends up back with the siblings. Just as the rescuers need rescuing, so the insurers may need insuring.

None of these practices seemed to dent the confidence of OFHEO in its charges. The regulator said as recently as July 10th that both Fannie and Freddie had enough capital. Indeed, their capital-adequacy requirement was reduced earlier this year so that they could make more of an effort to bolster the housing market.

Capital offence

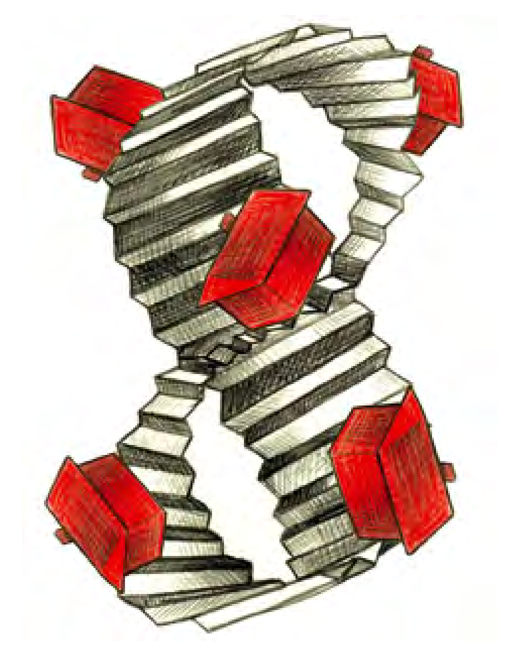
By its own measure, OFHEO was right. At the end of the first quarter, the two companies exceeded their minimum capital requirements by $11 billion apiece, according to CreditSights. To fall to the "critical level", which would require OFHEO to take the agencies into "conservatorship" (a fancy word for nationalisation), CreditSights says Fannie would have to lose $16 billion of capital and Freddie $14 billion. And because neither Fannie nor Freddie has depositors, there is no danger of their suffering a run, as Northern Rock, a British bank, did last year.

So why the crisis? Given the gearing in the businesses, things only need to go slightly wrong for there to be a big problem. Freddie lost $3.5 billion in 2007; Fannie reported a $2.2 billion loss in the first quarter, having lost $2.05 billion last year. Each had credit-related write-downs of between $5 billion and $6 billion last year. On a fair-value basis, which assumes that all assets and liabilities are realised immediately, Freddie had negative net worth of $5.2 billion at the end of the first quarter.

Illustration by Bob Venables

Clearly, if the pair continue to lose money for much longer, their capital base will be eroded. And, of course, Congress wanted their businesses to expand—meaning that more, not less, capital would be

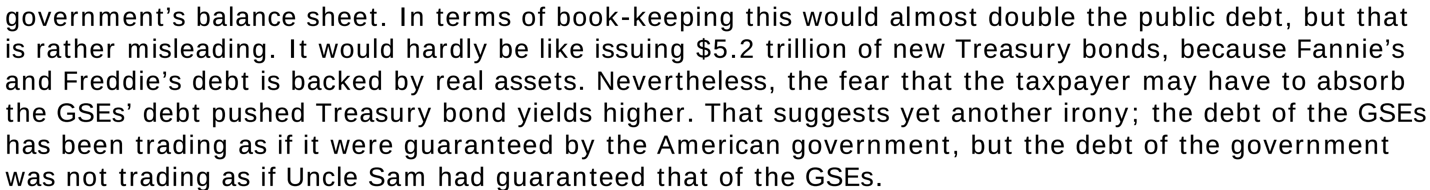
needed. That would require shareholders to stump up more money. But investors tend to anticipate a big equity-raising by selling the shares, and a falling share price makes an equity issue less likely. The fall was sufficiently speedy in mid-July to prompt Mr Paulson to step in. The stockmarket had called the government's bluff.



The rescue package may have reassured the creditors but it did not stop the share price of either Fannie or Freddie from falling. After all, the government is likely to extract a heavy penalty from shareholders in return for its support (creditors are another matter, especially as a lot of GSE paper is held by foreign central banks).

Nevertheless the hope is that, if confidence can be restored, Fannie and Freddie can survive without raising capital until market conditions improve. In the short term, as the success of the debt issue on July 14th showed, they should be able to go about their business.

The authorities are keen to avoid nationalisation, which would bring the whole of Fannie's and Freddie's debt onto the federal



government's balance sheet. In terms of book-keeping this would almost double the public debt, but that is rather misleading. It would hardly be like issuing $5.2 trillion of new Treasury bonds, because Fannie's and Freddie's debt is backed by real assets. Nevertheless, the fear that the taxpayer may have to absorb the GSEs' debt pushed Treasury bond yields higher. That suggests yet another irony; the debt of the GSEs has been trading as if it were guaranteed by the American government, but the debt of the government was not trading as if Uncle Sam had guaranteed that of the GSEs.

If Congress approves this package, the Fed will have more authority over the agencies. But that will give the central bank another headache. If an institution is struggling, the normal answer is to shrink its activities and wind it down slowly. But that is the last thing that the housing market needs right now.

With the credit crunch, Fannie and Freddie have become more important than ever, financing some 80% of mortgages in January. So they will need to keep lending. Nor is there scope to offload their portfolios of mortgage-backed securities, given that there are scarcely any buyers of such debt. And if the Fed has to worry about safeguarding Fannie and Freddie, can it afford to raise interest rates to combat inflation? American monetary policy may be constrained.

The GSEs are not the only liability for the government. IndyMac's recent collapse is the latest call on the Federal Deposit Insurance Corporation (FDIC). The FDIC has some $53 billion of assets, so it is better funded than most deposit-insurance schemes. But if enough banks got into trouble, the government would be on the hook for any shortfall. The same is true of the Pension Benefit Guaranty Corporation, which insures private sector benefits, but is already $14 billion in deficit.

In the end, the turtle at the bottom of the pile is the American taxpayer. But that suggests that, if Americans are losing money on their houses, pensions or bank accounts, the right answer is to tax them to pay for it. Perhaps it is no surprise that traders in the credit-default swaps market have recently made bets on the unthinkable: that America may default on its debt.

A brief family history

Toxic fudge

Jul 17th 2008
From The Economist print edition

Chartered by Congress; out for themselves

ADAM SMITH thought that private companies chartered to fulfil government tasks had "in the long run proved, universally, either burdensome or useless". That has not stopped them thriving. America has five government-sponsored enterprises (GSEs), set up to subsidise loans to homeowners or farmers. (Sallie Mae, which deals with students, gave up GSE status in 2004.) Because they count as privately owned, GSEs are kept off the government's books. For politicians that has made them irresistible ever since the Farm Credit System's creation in 1916.

Fannie Mae and Freddie Mac dominate the GSE system, accounting for four-fifths of its total credit portfolio. Fannie was created in 1938 as a government corporation. In 1968 the Johnson administration decided to list its shares to reduce the budgetary pressures created by the Vietnam war, according to Thomas Stanton, of Johns Hopkins University. Freddie was born in 1970 and listed in 1989. Both companies aim to support the secondary mortgage market. They have succeeded all too well: they own or guarantee about half of all mortgages.

Their supremacy reflects their privileges. As well as an implicit state guarantee, which allows them to fund themselves cheaply, they enjoy exemption from some taxes. They run with far less capital than banks and have more latitude to include as capital dubious items such as preference shares and tax assets. The capitalised value of these privileges is huge: between $122 billion and $182 billion, according to a 2005 study by the Federal Reserve.

It gets worse. The same analysis concluded that shareholders, who enjoy turbocharged gearing without higher borrowing costs, siphoned off about half of the subsidy. Managers trousered an unseemly sum too: between 1998 and 2003, Fannie's top five executives received $199m.

With so much at stake, no wonder the companies built a formidable lobbying machine. Ex-politicians were given jobs. Critics could expect a rough ride. The companies were not afraid to bite the hands that fed them: in 2004, the day before a congressional committee discussed the regulation of Fannie, the company ran a television advertisement attacking the committee. Their regulator, the Office of Federal Housing Enterprise Oversight, says its powers were weakened during its creation in 1992: for example, its budget must be approved annually by Congress and thus depends on political goodwill.

Accounting scandals in 2003-04 (the two firms restated earnings by a total of $11.3 billion) led to a change of management, and, supporters argue, of culture. The pace of balance-sheet expansion and accumulation of risky private-label securities has slowed. Yet neither company can be accused of anticipating the housing crash. An end to GSE status looks unlikely: as truly private companies Fannie and Freddie would require unrealistically large injections of equity. The government wants to avoid nationalisation. That leaves the status quo, the public subsidy of private profit: a combination as toxic as it was in Smith's day.

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Prediction markets

Fortune telling

Jul 17th 2008
From The Economist print edition

How to bet on the next bank collapse

Jupiter Images



SURPRISES, in the staid world of banking, tend to be of the unpleasant sort, as customers at IndyMac Bancorp, a California thrift, can attest. Cross a few palms with silver, however, and there is a new way to profit from others' unexpected losses. Punters can now bet on bank failures in America, thanks to 12 new contracts against individually named banks listed on July 16th by Intrade, the largest online prediction market.

Once viewed as grubby gambling dens, prediction markets have sharpened up. Intrade says it has brokered $76m of bets this year. Its data have been used as a price-discovery tool by America's Commodities Futures Trading Commission, the United States Navy, various Federal Reserve banks, and the European Central Bank. The accuracy of prediction markets makes them hard to ignore; they were better than Gallup polls in predicting the outcome of elections between 1998 and 2004. Using the wisdom of crowds, they do a good job of forecasting the outcome of sporting events.

Exchanges such as Britain's Tradefair and America's HedgeStreet have sought to apply this predictive power to financial markets, offering contracts on financial instruments, interest rates and commodities. CME Group, a Chicago-based exchange, launched its first economic-event contracts in April. But these markets do not appear to have taken off as successfully as election or sports markets, possibly because they struggle to strike the right balance between experts and laypeople. A bet on the merger that created CME Group received only 82 trades in its 80-day lifespan. When markets are that small, punters should watch carefully for signs of manipulation.

So far, it must be said, there appear to have been no deals on Intrade's bank-failure market. Top of its danger list, based on the bid-offer spread, is Miami-based BankUnited Financial, which has featured in news reports as one of several banks with a high ratio of non-performing loans to total assets. On July 16th BankUnited's share price more than doubled, however. The stockmarket is a more liquid place to bet on banks—but hedging against failure may be a sensible option if banks continue to go bust.

Buttonwood

Turning panic into opportunity

Jul 17th 2008
From The Economist print edition

How to tell when markets may have hit bottom

Illustration by Satoshi Kambayashi



WHEN all around are panicking, smart investors should be cooly asking whether it is time to buy. What signals should they be looking for?

One of the first measures is the VIX, or volatility index, which measures the variability of the American stockmarket. It is trading around the 30 level, or near its peak in March when Bear Stearns had to be rescued.

The theory is that, when volatility is high, markets are usually falling. That is because there is rarely such a thing as a "forced buyer" of shares. But there can be forced sellers, when investors need to dump their holdings to meet margin calls or repay debts. Faced with such selling, marketmakers adjust their prices sharply and that is what creates spikes in the VIX.

The VIX is well above its post-1990 average, according to the Chicago Board Options Exchange, which trades futures and options on the index. But it has yet to reach the heights seen in 2002, or when Long-Term Capital Management, a hedge fund, was being rescued in 1998. Both incidents, which pushed the VIX above 40, proved to be good moments to buy shares on a 12-month view.

A second signal may seem a bit parochial to international readers. It is when the dividend yield on the FTSE All-Share (the broad-based British index) is higher than the yield on ten-year gilts, or government bonds. In other words, investors get paid more to hold equities (with all their growth prospects) than stodgy government bonds. The market passed this threshold on March 12th 2003 for the first time since the late 1950s. To the day, it marked the end of the 2000-2003 global bear market. At the time some commentators said this signal did not matter, since dividends would probably be cut. In fact, the dividend income on the index has almost doubled in the five years since.

As of July 16th, the yield on the All-Share was 4.46% and the ten-year gilt yielded 4.95%. That suggests that a further 10% fall in the stockmarket would do the trick. There is, of course, the risk that dividends will be cut if Britain, or indeed the world, goes into recession. But this crossover is a signal of long-term value. It is highly likely that dividend income will increase by 2018. But it is certain, if you buy a ten-year gilt, that you will get the same nominal income in 2018 as you do now.

Another measure that could make shares attractive is a single-digit price/earnings ratio. Higher inflation tends to drive down p/es, because it leads to more volatile economic conditions. Investors may also be worried that profits are high, relative to GDP, and are thus due for a fall.

But single-digit p/es would compensate investors for those risks. Flip the ratio around and you have the earnings yield, the percentage of the share price that is represented by profits. If the p/e is in single digits, the earnings yield is above 10%. On the latest data, a number of European markets, including Belgium, France, Ireland, Italy, the Netherlands, Spain and Sweden fall into this category; with the DAX on a p/e of 10.6, Germany is not that far away. (Wall Street, by contrast, has still a fair amount to fall on this measure.)

On valuation grounds, therefore, investors should at least be thinking about opening their wallets. Of course, valuation is not the only factor that drives markets, as became clear during the dotcom bubble. Just as prices can be driven far above fair value in periods of euphoria, so they can be driven far below it in periods of fear.

And sentiment is pretty depressed. The latest Merrill Lynch survey of global fund managers, released on July 16th, found that a record number were overweight in their holdings of cash and underweight in shares, and most thought that profit forecasts were far too high. That poll suggests investors are already braced for a good deal of bad news.

What is needed to get markets out of their funk is a catalyst. It would help if the uncertainty cleared. In both 1991 and 2003, markets rallied as wars against Iraq began. That was not because the wars were good news, but because investors had been made so uncertain by the pre-war tensions.

The fundamental problem this time is economic and financial, rather than geopolitical. As well as the credit crunch, investors are worried by the combination of higher-than-expected inflation and slower growth, and the fear that central banks will be seduced into setting monetary policies that are too loose or too tight. So the best news of the week, buried under all the headlines about falling bank share prices, was the sharp drop in the price of oil. A belief that oil could soon be in double, not triple, digits really would be the catalyst for a rally.

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Aftermath of a mega-merger

Three amigos, only one conquistador

Jul 17th 2008
From The Economist print edition

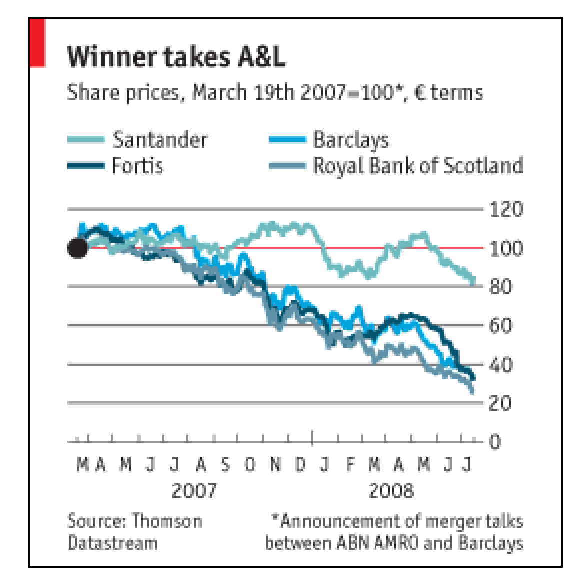
Mixed fortunes for the buyers of ABN AMRO

TO THE victors, the toils. Less than a year has passed since the bosses of Royal Bank of Scotland (RBS), Fortis, a Belgo-Dutch lender, and Santander of Spain celebrated the biggest deal in banking history, the €72 billion ($101 billion, at the time) acquisition of ABN AMRO, a Dutch bank. Their divergent fortunes since then reflect the woeful state of European banking.

Start with the casualties. Jean-Paul Votron lost his job as chief executive of Fortis on July 11th, paying the price for his announcement in June that the bank was raising another €8.3 billion of capital by selling assets, placing shares and scrapping its interim dividend. The bank tapped shareholders for €13.4 billion in 2007 to pay for its €24 billion portion of the ABN deal and had denied until recently that it needed more cash. Enraged investors asked the Dutch regulator to investigate whether those assurances amounted to misinformation—the effect was to depress the value of their holdings even further. The bank was even moved to deny rumours that depositors were withdrawing their savings on July 15th. Some think the company may be in play, with ING mooted as a possible buyer.

Mr Votron hoped to make his reputation with the ABN deal. Sir Fred Goodwin, the boss of RBS, has ended up losing his. He too has asked shareholders to stump up, after denying that he would need more capital: the bank's £12 billion ($24 billion) rights issue closed last month but the pain for RBS continues. Its shares were hammered on July 15th, as investors fretted about its exposure to the transatlantic mortgage meltdown, via its Citizens unit, and the stuttering sale of its insurance arm.

Defenders of the ABN transaction, a lonely band, point out that shares in Barclays, which lost the battle for the Dutch bank, have fallen almost as far as those in RBS and Fortis (see chart). These two banks may well have had to raise capital anyway, given large write-downs in their own businesses. And the deal did give them some useful assets. But both RBS and Fortis picked the wrong time and paid the wrong price for their bits of ABN. Arturo de Frias, an analyst at Dresdner Kleinwort, reckons that RBS paid 17.6 times tangible book value (adjusting for goodwill and subsequent write-downs) for ABN's wholesale business and Asian operations, and that Fortis shelled out 14.2 times book value for its Dutch retail, asset-management and private-banking arms. European banks today trade at roughly book value.



It does not help that the third member of the consortium, Santander, is one of the very few banks in the region to look sprightly. It cushioned the financial impact of the deal by swiftly flipping ABN's Italian retail network on to another buyer. It kept ABN's Brazilian operations, which still promise buoyant growth. And thanks in large part to Spanish banking regulations, Santander avoided the subprime mess. As a result, it is still able to do deals.

On July 14th Santander announced a £1.26 billion bid for Alliance & Leicester (A&L), a smallish British lender. Shareholders grumbled that the price undervalues A&L, but the A&L board, which backs the bid, has a clearer-eyed view. Small banks with a liking for the moribund wholesale markets as sources of funding are not much in vogue nowadays.

There is muted speculation that other banks may be tempted to make bids but possible contenders are scarce. The fit between Abbey, Santander's existing British subsidiary, and A&L is unusually snug. Lloyds, the likeliest counter-bidder, is under pressure to diversify abroad.

Santander is not without worries. Taking a bet on Britain's crumbling housing market is not for everyone: it will make a £1 billion injection of capital into A&L, some of which is insurance against further write-downs. The Spanish bank's home market is also in trouble. Martinsa-Fadesa, a large property developer, declared itself bankrupt on July 14th. But compared with the storms battering other banks in the region, these are, for the time being, wisps of cloud in an otherwise blue Iberian sky.

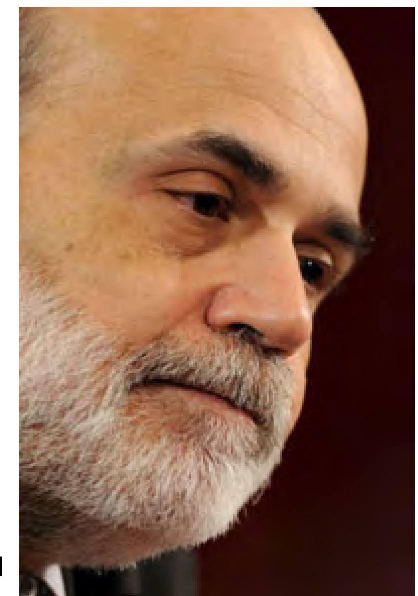
America's economy

Boxed-in Ben

Jul 17th 2008
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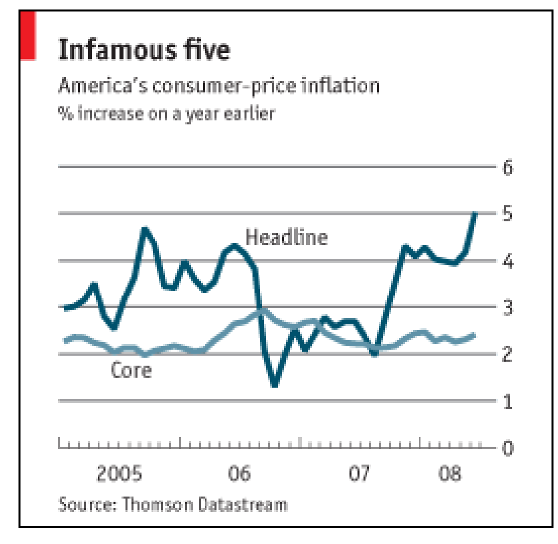
For the Federal Reserve chief, even good news turns out to be bad

EPA



JITTERY investors and anxious politicians have often relied on Federal Reserve chairmen to conjure up something to steady their nerves. But when Ben Bernanke gave his twice-yearly monetary testimony to Congress on July 15th and 16th, he had little to offer but unvarnished and uncomfortable truths. There were "significant downside risks" to the economy's outlook, he said, and the chances that high inflation would persist had "intensified". Mr Bernanke did not specify which was the bigger threat: recession or inflation. This lack of a clear policy bias invited the conclusion that, for the time being at least, the Fed thinks it cannot safely move interest rates in either direction.

With financial markets buffeted by renewed fears about the credit drought and a deepening housing slump, Mr Bernanke could hardly boast of the economy's soundness. To make matters worse, figures released as the Fed chairman gave his second day of testimony showed that year-on-year inflation rose in June to 5.0% (see chart), the highest rate since 1991. Paltry pay rises, as well as job losses, mean employment income is probably growing by less than 3%, well below the inflation rate. Falling real income, slumping share and house prices and tighter credit all cast a cloud over consumer spending. Firms worried about future demand will be more cautious too about shelling out for costly capital projects, even if they could raise the finance.



Despite these unsettling prospects, the Fed's rate-setters bumped up their forecasts for GDP growth in 2008, to 1.0-1.6%, from the 0.3-1.2% range set out in April. According to the central bank's 48-page report to Congress, the upgrade was prompted by stronger data on consumer and business spending between April and June. Private-sector analysts are revising up their forecasts for this year too. The first estimate of second-quarter GDP, released on July 31st, is likely to show that the economy grew at an annualised rate of around 2%, twice as fast as in the first quarter.

The Fed's trouble is that, though the economy has avoided recession so far, it may not do so for much longer. Indeed Mr Bernanke acknowledged that some of the demand that the Fed had hoped for later this year may have already come and gone. So the economy's first-half resilience may be of more concern than comfort.

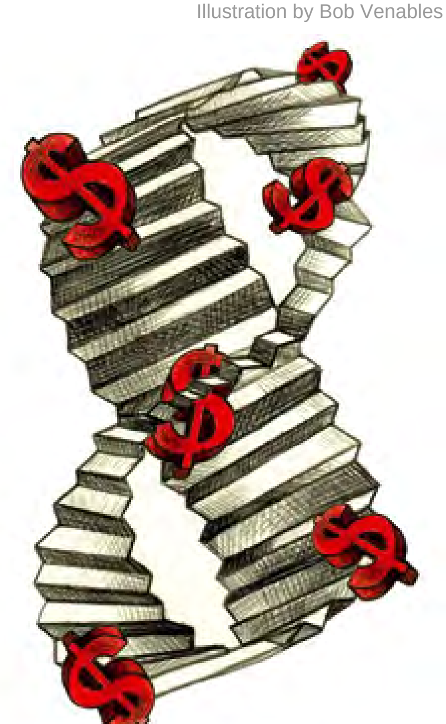
The performance of companies and consumers shows why. Businesses received some extra tax relief as part of February's fiscal-stimulus package, which may have helped a little to stave off recession. There was also a spurt in the construction of offices, hotels and other business structures in the spring. However, this burst of activity may have been just the fag-end of the commercial-property boom. "These are projects that were planned when money was cheap," says Kevin Logan, an economist at Dresdner Kleinwort in New York. Now conditions have deteriorated: vacancy rates for offices are rising and retail chains, such as Gap, are closing stores.

Consumer spending seems likely to flag too. A jump in retail sales in April and May owed something to the tax rebates first sent out at the end of April. By July 11th around $92 billion of the expected $110 billion of rebates had been disbursed. With household finances under so much pressure, consumers probably

leant more heavily on the rebate cheques than had been expected. But a slim rise in retail sales in June is a hint that the effects of this one-off stimulus may already be fading.

Another crutch for consumers has been the home-equity loan. Borrowing from this source rose by 3.8% between March and June, despite a big fall in overall bank credit. This increase came about partly because access is blocked to other forms of borrowing, such as mortgage refinancing. It may also be a sign of distress borrowing, as consumers battle with rising living costs. That battle will become harder if, as anecdotal evidence suggests, banks are cutting pre-arranged credit lines.

Illustration by Bob Venables



The brightest hope for America's economy is its foreign sales. Net trade added more than one percentage point to GDP growth in the year to the first quarter. The weak dollar is still helping American firms take advantage of the strong demand in other parts of the world. Export volumes rose by 10.1% in the first five months of the year, compared with the same period in 2007. But even here, the future is looking bleaker. Rising global inflation, spurred in part by countries with dollar pegs mimicking the Fed's rate cuts, is now prompting central banks in many emerging economies to tighten monetary policy. That will curb demand for imports. America's richer trading partners are struggling too. The euro-area economy may have shrunk in the second quarter. The outlook for Japan and for Britain has worsened too.

There is little that central banks can do to support the economy when inflation is rising dangerously high. The Fed's hands are tied by its concern that today's inflation may lead to higher wages. Mr Bernanke is "in a box", says Michael Feroli, an economist at JPMorgan Chase. The Fed chief has to sound hawkish to show that he has not lost sight of inflation. But equally he cannot set out a plan for interest-rate increases when the financial system is so wobbly.

The good news in the first half may even make the Fed's job harder. If consumers have already used up much of their tax rebates and credit lines, spending is likely to flag soon. A first-half recession followed by a sluggish recovery—the standard forecast until recently—could well have enabled the Fed to raise rates in the autumn. But with the worst news on the economy yet to come, Mr Bernanke can only keep his fingers crossed that inflation does not become ingrained.

Financial regulation

Grasping at shorts

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America's SEC fights dirty

BEAR markets often involve bare-knuckle fights, but it is still a shock when the referee starts punching below the belt. The Securities and Exchange Commission (SEC) has intervened in the epic struggle between financial companies and the hedge funds that are short-selling their shares.

Desperate to prevent more collapses, the main stockmarket regulator has slapped a ban for up to one month on "naked shorting" of the shares of 17 investment banks, and of Fannie Mae and Freddie Mac, the two mortgage giants. Some argue that such trades, in which investors sell shares they do not yet possess, make it easier to manipulate prices. The SEC has also reportedly issued over 50 subpoenas to banks and hedge funds as part of its investigation into possibly abusive trading of shares of Bear Stearns and Lehman Brothers.

The SEC's moves deserve scrutiny. Investment banks must have a dizzying influence over the regulator to win special protection from short-selling, particularly as they act as prime brokers for almost all short-sellers. There is as yet no evidence that market abuse has driven down financial firms' share prices—and plenty that their trashed balance-sheets and credibility have. London's financial-services regulator has as yet failed to provide evidence to justify its decision to tighten the disclosure rules on short-selling of some bank shares.

The SEC's initiatives are asymmetric. It has not investigated whether bullish investors and executives talked bank share prices up in the good times. Application is also inconsistent. The S&P500 companies with the biggest rises in short positions relative to their free floats in recent weeks include Sears, a retailer, and General Motors, a carmaker. Like the Treasury and the Federal Reserve, the SEC is improvising in order to try to protect banks. But when the dust settles, the incoherence of taking a wild swing may become clear for all to see.

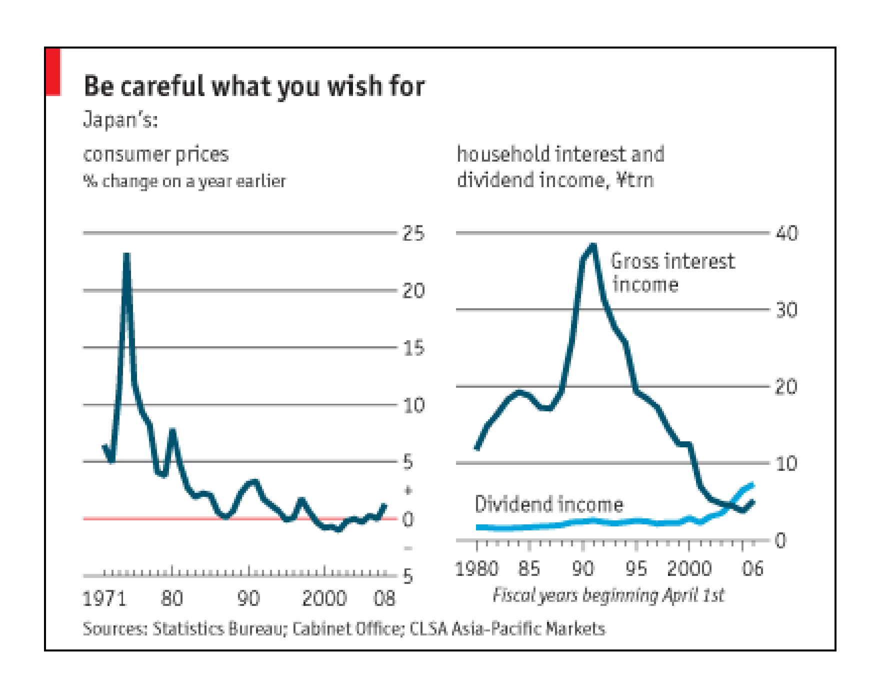
Economics focus

Land of the rising price

Jul 17th 2008
From The Economist print edition

Japan has long hoped for a bit of inflation—but not this sort

JAPAN, people like to argue, is one place that should greet the return of inflation with joy. The country, after all, has been in the grip of deflationary forces for over a decade. Even after an economic recovery which began in 2002, the lingering deflationary mindset has meant firms have struggled to raise prices or pay better wages. Lacking animal spirits, a long-predicted virtuous circle—where higher profits would lead to bigger pay packets, leading to more spending in the economy, and so on—has failed to come about, so the recovery has depended too much on exports. A burst of inflation, the Japan bulls say, will provide just the shot in the arm that the economy needs.



Prices are indeed on the rise (see left-hand chart). In the decade to 2007, prices fell on average by 0.2% a year. On July 15th the Bank of Japan (BoJ) raised its forecast for "core" inflation in the fiscal year ending in March 2009 to 1.8%, up from 1.1% three months ago. Goldman Sachs thinks core inflation, which strips out volatile fresh-food prices and is the most widely followed measure, reached 2% in June, up from 1.5% in May. As elsewhere in Asia, higher prices for oil and food are the main cause of the jump in headline inflation. But even Japan's "core core" inflation rate, which strips out both energy and fresh food, is ticking up, as higher prices for wholesale goods pass on to consumers.

All this, says Christopher Wood of CLSA, a broker, is "unambiguously positive", because companies will regain their pricing power and because employees will, in time, get wage rises. Mr Wood, who has consistently predicted the unfolding of America's financial crisis, is as bullish on the Japanese stockmarket as he is bearish on the American one.

Push v pull

But others question the bulls' assumptions. John Richards, of the Royal Bank of Scotland in Tokyo, points out that since inflation is almost entirely due to dearer food and energy, both of which Japan imports, rather than because of rising domestic demand, it reflects an unwelcome worsening of the country's terms of trade.

The prices of Japan's exports relative to imports have deteriorated for at least four years, but until

recently growth in companies' sales volumes had more than made up for that. Japan's recovery was underpinned by strong exports, first to China and more recently to Europe and oil-exporting countries. Yet demand from Asia, which takes half of Japan's exports, has slowed this year. In value terms, exports to America are shrinking. Now, export growth to Europe looks as if it is wobbling.

Higher prices not only do harm to Japan's external strength. Contrary to Mr Wood's assertions, the evidence so far suggests that they are eating into workers' real earnings, and hurting companies' profit margins at home (as they have difficulty passing on higher costs). That undermines the willingness of firms to hire or invest. The pressure on companies to cut costs is nothing like it was when Japan was trying to dig itself out of its post-bubble mess. Still, company profits are now falling from record levels. In the first three months of 2008 operating profits were 17.5% lower than a year earlier. Historically, free cashflow is a good predictor in Japan of business investment, which, behind exports, has helped drive Japan's six-year recovery. Now the BoJ's latest *Tankan* survey of business conditions, published on July 1st, sketches a picture of worsening sentiment. Consumers are also showing signs of belt-tightening.

Not unambiguously good for Japan, in other words, but inflation may not be unambiguously bad either. An unnatural share of Japanese households' financial assets—51% or ¥785 trillion ($7 trillion)—are stuffed under the futon or in deep freezes, or held in bank accounts that pay no interest. This risk-averse habit is a legacy of the post-bubble deflation years, when the zero nominal return on cash looked pretty good compared with the alternatives.

No longer, perhaps. This week the BoJ kept its benchmark interest rate on hold, at just 0.5%. Richard Jerram, of Macquarie Capital Securities in Tokyo, points out that real interest rates are now firmly negative, among the lowest of any G8 economy. With the value of savings now trimmed by inflation, he wonders whether households will at last shift savings out of cash and into other assets—shares, property—offering the prospect of higher returns. After all, households' interest income has fallen by almost nine-tenths since the early 1990s (see right-hand chart).

Predictions of just such a switch have been made countless times over the years. The difference now is that inflation expectations are rising fast. A BoJ survey released on July 4th suggested that ordinary Japanese think inflation has run at 10% over the past year. Historically, it has taken some form of external shock or pressure from overseas, known as *gaiatsu*, to induce rapid and profound change in Japan (as a result of the 1970s oil shock, for example, Japan started liberalising its finance industry). Inflation, argues Mr Wood, even of the bad, cost-push variety, will prove another form of *gaiatsu*. And when Japanese group behaviour changes, he warns, it will change fast.

Will that happen yet? One reason to think not is that the central bank has not been able to raise interest rates anything like as quickly as it would like. It has long wanted to "normalise" monetary policy, raising rates to somewhere near 2.5-3%, but darkening economic clouds abroad and at home keep conspiring to prevent that. As well as keeping rates on hold, at its regular policy-board meeting this week, the BoJ lowered its forecast for growth this fiscal year, from 1.5% to 1.2%.

For as long as money remains cheap, the second element of the optimists' case—corporate restructuring—is unlikely to take hold. Without the discipline of higher rates, "zombie" companies will continue to eke out a living on a drip of cheap credit, while plenty of unproductive sectors and smaller businesses will escape the kind of consolidation they need. Falling profits and a lack of reform: that hardly makes for a bullish story quite yet.

Cognition nutrition

Food for thought

Jul 17th 2008
From The Economist print edition



Eat your way to a better brain

CHILDREN have a lot to contend with these days, not least a tendency for their pushy parents to force-feed them omega-3 oils at every opportunity. These are supposed to make children brainier, so they are being added to everything from bread, milk and pasta to baby formula and vitamin tablets. But omega-3 is just the tip of the nutritional iceberg; many nutrients have proven cognitive effects, and do so throughout a person's life, not merely when he is a child.

Fernando Gómez-Pinilla, a fish-loving professor of neurosurgery and physiological science at the University of California, Los Angeles, believes that appropriate changes to a person's diet can enhance his cognitive abilities, protect his brain from damage and counteract the effects of ageing. Dr Gómez-Pinilla has been studying the effects of food on the brain for years, and has now completed a review, just published in *Nature Reviews Neuroscience*, that has analysed more than 160 studies of food's effect on the brain. Some foods, he concludes, are like pharmaceutical compounds; their effects are so profound that the mental health of entire countries may be linked to them.

Last year, for example, the *Lancet* published research showing that folic-acid supplements—sometimes taken by pregnant women—can help those between 50 and 70 years old ward off the cognitive decline that accompanies ageing. In a study lasting three years, Jane Durga, of Wageningen University in the Netherlands, and her colleagues found that people taking such supplements did better on measures of memory, information-processing speed and verbal fluency. That, plus evidence that folate deficiency is associated with clinical depression, suggests eating spinach, orange juice and Marmite, which are all rich in folic acid.

Another suggestion from Dr Gómez-Pinilla's review is that people should eat more antioxidants. That idea is not new. Antioxidants are reckoned by many to protect against the general effects of ageing. Vitamin E, for example, which is found in vegetable oils, nuts and green leafy vegetables, has been linked (in mice) with the retention of memory into old age, and also with longer life.

Dr Gómez-Pinilla, however, gives the antioxidant story a particular twist. The brain, he observes, is peculiarly susceptible to oxidative damage. It consumes a lot of energy, and the reactions that release this energy also generate oxidising chemicals. Moreover, brain tissue contains a great deal of oxidisable material, particularly in the fatty membranes surrounding nerve cells.

That suggests, among other things, the value of a diet rich in berries. These have been shown to have strong antioxidant effects, though only a small number of their constituents have been evaluated in detail. One group that has been evaluated, the polyphenols, has been shown in rodents to reduce oxidative damage and to boost the ability to learn and retain memories. In particular, these chemicals affect

changes in response to different types of stimulation in the hippocampus (a part of the brain that is crucial to the formation of long-term memories, and which is the region most affected by Alzheimer's disease). Another polyphenol, curcumin, has also been shown to have protective effects. It reduces memory deficits in animals with brain damage. It may be no coincidence that in India, where a lot of curcumin is consumed (it is the substance that makes turmeric yellow), Alzheimer's disease is rarer than elsewhere.

Peas of mind

Though the way antioxidants work in the brain is not well known, Dr Gómez-Pinilla says it is likely they protect the synaptic membranes. Synapses are the junctions between nerve cells, and their action is central to learning and memory. But they are also, he says, the most fragile parts of the brain. And many of the nutrients associated with brain function are known to affect transmission at the synapses.

An omega-3 fatty acid called docosahexaenoic acid (DHA), for example, provides membranes at synaptic regions with "fluidity"—the capacity to transport signals. It also provides "plasticity"—a synapse's capacity to change. Such changes are the basis of memory. Since 30% of the fatty constituents of nerve-cell membranes are DHA molecules, keeping your DHA levels topped up is part of having a healthy brain. Indeed, according to the studies reviewed by Dr Gómez-Pinilla, the benefits of omega-3s include improved learning and memory, and resistance to depression and bipolar disorder, schizophrenia, dementia, attention-deficit disorder and dyslexia.

Omega-3s are found in oily fish such as salmon, as well as in walnuts and kiwi fruit, and there is a strong negative correlation between the extent to which a country consumes fish and its levels of clinical depression. On the Japanese island of Okinawa, for example, people have a strikingly low rate of mental disorder—and Okinawans are notable fish eaters, even by the standards of a piscivorous country like Japan. In contrast, many studies suggest that diets which are rich in trans- and saturated fatty acids, such as those containing a lot of deep-fried foods and butter, have bad effects on cognition. Rodents put on such diets show declines in cognitive performance within weeks.

In the past few years, several studies have looked at the effect of adding omega-3s to people's diets—particularly those of children. One such, carried out in the British city of Durham, was controversial in that it was funded by a maker of children's omega-3 supplements and did not include a control group being given a placebo. Despite the publicity this study has received, Ben Goldacre, author of a book called "Bad Science" that includes an investigation of it, says the results will not be released.

Work by other researchers, however, has suggested such supplements do improve the performance and behaviour of school-age children with specific diagnoses such as dyslexia, attention-deficit disorder and developmental co-ordination disorder. Moreover, although more work is needed to elucidate the effects of omega-3s on healthy school-age children, Dr Gómez-Pinilla says that younger children whose mothers took fish-oil supplements (which contain omega-3s) when they were pregnant and while they were breast-feeding do show better cognitive performance than their unsupplemented contemporaries.

Eating well, then, is one key to a healthy brain. But a word of warning—do not overeat. This puts oxidative stress on the brain and risks undoing all the good work those antioxidants have been up to. For those who would like a little practical guidance, *The Economist* has some suggestions for dinner (see menu). So why not put the Nintendo brain trainer away tonight, and eat your way to intelligence instead?

BRAIN *FOOD*

STARTER

Avocado, spinach & lettuce salad, with a scattering of pine nuts and toasted crumbled anchovies, and dressed with olive oil & balsamic vinegar



MAIN COURSE

Salmon curry with turmeric potatoes and cauliflower, served with lentil daal*



DESSERT

Dark chocolate clusters of walnuts, Brazil nuts, almonds, candied fruit and peel, with red and blue berries & kiwi compote



DRINK OPTIONS

Californian Cabernet Sauvignon, green tea, freshly squeezed orange juice, glass of milk



Brain-related nutrients included in the meal: omega-3 (salmon, kiwi, walnuts); curcumin (turmeric); flavonoids (cocoa, green tea, citrus fruits, red wine, dark chocolate); vitamins B, D & E (lentils, cauliflower, asparagus, avocado, almonds, walnuts, spinach, olive oil); choline (lentils, lettuce); vitamin C & carotene (citrus and berry fruits); calcium, zinc & selenium (milk, nuts, fish); copper (Brazil nuts, cocoa, black-pepper); iron (fish, lentils).
*We minimise the use of saturated fats found in foods such as butter, ghee, suet, lard, coconut oil and dairy products.

CAFE

AIDS

DARC continent

Jul 17th 2008
From The Economist print edition

A tiny genetic change may help explain why AIDS is so common in Africa

Reuters



Facing an unpleasant truth

WHY is AIDS so much more prevalent in Africa than in other parts of the world? The question is both important and controversial. It is important because two-thirds of those infected with HIV, the virus that causes the disease, live on that continent. It is controversial because some of the explanations are behavioural, and are seen by many as racist slurs.

Broadly, there are three proposed explanations. One is that because AIDS started in Africa, it has had more time to spread there. The second—the behavioural one—is that both formal and informal polygamy are more common in Africa than elsewhere. The third is that African physiology is unusually susceptible to the disease.

All three probably play a part. But a paper just published in *Cell Host & Microbe* suggests that a significant part of the answer may indeed be physiological. Weijing He of the University of Texas Health Science Centre, in San Antonio, and his colleagues have discovered that a genetic variation which is common in Africa both makes people more susceptible to infection and keeps them in a symptom-free state for longer, allowing them to pass the disease on.

Surface tension

This variation involves the flipping of a single genetic "letter" in a gene called *DARC* (the Duffy antigen receptor for chemokines). This gene, as its name suggests, encodes a protein that regulates the level in the bloodstream of inflammation-causing chemicals called chemokines. That protein sits, among other places, on the surfaces of red blood cells. Or, rather, in the variant, it doesn't. The mutation means that Duffy receptor proteins are not made in red cells.

Since other chemokine receptors are known to be involved in AIDS, and since two-thirds of sub-Saharan Africans lack the Duffy receptor on their red blood cells although such a lack is rare in other groups of people, it seemed an obvious candidate for investigation. Unfortunately, the team did not have a suitable group of Africans available for study. They did, however, have access to a group of American airmen, some of whom are of African descent. America is good at looking after its servicemen's health and, in exchange, many of those airmen have agreed to be part of a long-term medical study that looks at all sorts of health-related questions. Indeed, some have participated in this study for 22 years.

Dr He and his colleagues looked at the genes of airmen who classified themselves as black and found that the ones infected with HIV were more likely to lack red cells bearing the Duffy receptor than chance would suggest. Moreover, and more unexpectedly, such people took two years longer to progress from the point where they were infected with the virus to the one where they began to show the first symptoms of AIDS. That is two years when a man ignorant of his infection would be less likely to take precautions to stop it spreading. The upshot, when the team crunched the numbers, was that the variant form of *DARC* may be responsible for 11% of the African epidemic.

The mystery is why the variant of *DARC* that leaves red blood cells without receptors should be so harmful. The team also did some laboratory experiments, which showed that HIV binds to the receptor. Although that mops up HIV from the bloodstream, the virus then passes from the red blood cells to the

white immune-system cells most susceptible to infection. An absence of receptors should therefore be a good thing, because it closes off a shortcut to infection. Clearly it is not, nor do the team know why their absence prolongs the period that the disease is latent.

That is an important lesson about the difficulty of extrapolating laboratory results into the real world. Had the two arms of the study not been carried out in parallel, future researchers might have travelled up an expensive and time-consuming blind alley.

Another question is why such a disastrous mutation should have spread so widely in Africa. The answer is probably that it once protected against another disease, malaria. Indeed, it still does, to a certain extent. The variant form of *DARC* stops the growth of *Plasmodium vivax*, one of the four parasites that can cause malaria. This parasite is not, however, as deadly as *Plasmodium falciparum,* the main cause of malarial mortality. Nor is it as widespread in Africa. But it is not just people who evolve to evade pathogens. Pathogens evolve to evade the evasions. And that is what Robin Weiss of University College, London, another member of the team, suspects has happened. He reckons *falciparum* was once controlled by variant *DARC*. But no longer. It has managed to escape that control, and left humanity with a genetic weakness that another pathogen, HIV, has exploited.

Digital libraries

Great minds think (too much) alike

Jul 17th 2008
From The Economist print edition

Is the web narrowing scientists' expertise?

Jupiter Images



Give me the broader prospective, please

ONLINE databases of scientific journals have made life easier for scientists as well as publishers. No more ambling down to the library, searching through the musty stacks and queuing up for the photocopier. Instead, a few clicks of a mouse can bring forth the desired papers and maybe others that the reader did not know of—the "long tail" of information that the web makes available.

Well, that is how it is supposed to work, but does it? James Evans, a sociologist at the University of Chicago, decided to investigate. His conclusion, published in this week's *Science*, is that the opposite is happening. He has found that as more journals become available online, fewer articles are being cited in the reference lists of the research papers published within them. Moreover, those articles that do get a mention tend to have been recently published themselves. Far from growing longer, the long tail is being docked.

Dr Evans based his analysis on data from citation indexes compiled by Thomson Scientific (part of Thomson Reuters). In a world in which researchers must publish or perish, such indexes are the firing squads. They record how often one article is cited as a source by others, and thus measure a paper's influence. Those used by Dr Evans cover 6,000 of the most prominent academic journals, some going back to 1945. By cross-referring these to a database called *Fulltext Sources Online*, he was able to work out when each of these journals became available on the web—and whether a journal had posted back-issues electronically as well. The result was a set of 34m research papers, which he was able to mine in search of his answers.

For each research paper he looked at, he calculated the average age of the articles cited as references. He then calculated, for each of those cited articles, the number of back-issues of the journal it had been published in which were available on the web at the time when it was cited, and averaged that too. Finally, he looked for correlations between the two averages.

What he discovered was that, for every additional year of back-issues of a journal available online, the average age of the articles cited from that journal fell by a month. He also found a fall, once a journal was online, in the number of papers in it that got any citations at all. Indeed, he predicts that for the average journal today, five extra years' worth of online availability will cause a precipitous drop in the number of articles receiving one or more citations—from 600 to 200 a year. Rather than measuring the length of the tail, then, it seems that modern science is actually focusing on a tiny bit of it.

Why this should be so remains unclear. It does not seem to have anything to do with economics. The same effect applied whether or not a journal had to be paid for. One explanation could be that indexing works by titles and authors alone, as happened with printed journals, forced readers to cast at least a cursory glance at work not immediately related to their own—or even that the mere act of flicking through a paper volume may have thrown up unexpected gems. This may have led people to make broader comparisons and to integrate more past results into their research.

It is not yet clear whether this change is for good or ill. Electronic searching means that no relevant paper is likely to go unread, but narrowing the definition of "relevance" risks reducing the cross-fertilisation of ideas that sometimes leads to big, unexpected advances. As a wag once put it, an expert is someone who knows more and more about less and less until, eventually, he knows everything about nothing. It would be ironic if that is the sort of expertise that the world wide web is creating.

Trade

The greatest journey

Jul 17th 2008
From The Economist print edition

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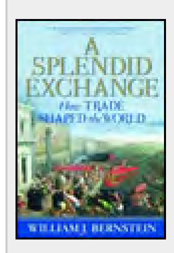


Largely for better, sometimes for worse, our world has been defined by trade

Bridgeman Art Library



A Splended Exchange
By William J Bernstein



Atlantic Monthly Press; 467 pages; $30. Atlantic Books; £22

WORLD trade gets a bad press: to many people globalisation seems more of a menace than an opportunity. Whether it is the threat to the environment posed by the phenomenal growth of Chinese manufacturing exports, the outsourcing of jobs by footloose corporations or the re-emergence of inflation as oil heads for $150 a barrel and food prices soar, trade is cast as the villain. As this year's American presidential election campaign heads for the final straight, the candidates, especially Barack Obama, will face ever more strident demands to protect workers from "unfair" foreign competition.

By contrast, too little is heard about the positive effects of world exports that reached $14 trillion in 2006. The boost to Western living standards from all those cheap Chinese goods is taken for granted, while the astonishing increase in the sum of human happiness that has been wrought by lifting hundreds of millions of Asians from the misery of subsistence farming into comfortable prosperity is conveniently forgotten.

William Bernstein's "A Splendid Exchange" is a timely and readable reminder that the desire to trade is not only one of the oldest human instincts but also the cause of many of the most important developments in our shared history. As Adam Smith observed: "The propensity to truck, barter and exchange one thing for another is common to all men, and to be found in no other race of animals."

Mr Bernstein's purpose is to show how that trait evolved and shaped the world. His story begins with Sumerian farmers who realised, some time in the third millennium BC, that the surpluses of grain generated within Mesopotamia's fertile crescent could be used as barter for things they did not have. Among these was copper, obtained from Sinai several hundred miles to the west, that could be used to make weapons to repel the nomadic raiders who were otherwise helping themselves to the fruits of Sumerian labour.

Mr Bernstein eschews a rigidly chronological narrative in favour of a more thematic approach. His discussion of the disastrous Peloponnesian war between Athens and Sparta serves to make a wider point about the importance (and vulnerability) of sea-lanes. The Athenians were driven by the dictates of trade to create first a powerful navy and then an empire.

Though Greek agriculture was rich in highly exportable wine and olive oil, thin soil, low rainfall and a mountainous topography made it impossible for farmers to produce enough grain for a growing and increasingly city-based population. The Spartans and their allies looked west to Sicily but the Athenians increasingly relied on access to the breadbasket of Pontus (modern Ukraine). This, in turn, meant keeping open those narrowest of choke points: the Dardanelles (to the Greeks, the Hellespont) and the Bosphorus.

Other states in the region were just as dependent on the trade with Pontus and were therefore prepared to contribute to the costs of Athenian naval operations. Before long, this "coalition of the willing" evolved into the Athenian empire. However, with two rival power blocks competing for resources within a relatively confined space, conflict was inevitable and when it came, it was Athens, always more exposed than Sparta, that was eventually starved to defeat. Today, it is the Straits of Hormuz, through which much of the world's oil is carried, that has acquired the same strategic importance as the Hellespont had for the Athenians.

With an ability to switch gracefully from the macro to the micro, Mr Bernstein whisks his reader on a tumultuous journey. Along the way, it takes in the Pax Islamica established in the Mediterranean by the heirs of the Prophet Muhammad (a trader by profession himself); the rise and decline of Venice and Genoa; the devastation caused by the Black Death; the Portuguese-led age of discovery; the establishment of the great Dutch and British East India trading companies; the horrors of the transatlantic slave trade; the campaign (that led, among other things, to the founding of this newspaper) to abolish the Corn Laws; the golden period of the late 19th century in which trade flourished under the benign wing of the British empire; and the 20th century's descent into beggar-my-neighbour protectionism.

The strength of Mr Bernstein's book is the analytical rigour that overlays the rollicking history and the way in which he seamlessly weaves in the theoretical with the practical. For anyone wanting a painless primer in the ideas of Adam Smith, David Ricardo or more recent economists, such as Paul Samuelson, this is the place to find it. At the same time, Mr Bernstein never neglects the vital role of technology as a driver of trade, above all perhaps the coming of steam and reliable refrigeration.

The author also deserves credit for his willingness to take seriously the plight of the victims of trade, the workers and farmers displaced by the iron rule of comparative advantage. He argues, persuasively, that it is far better to help workers affected by disruptive change than it is to shield industries with efficiency-destroying tariffs.

If Mr Bernstein has one overriding message it is that trade "has yielded not only a bounty of material good, but also of intellectual and cultural capital, an understanding of our neighbours, and a desire to sell things to others rather than to annihilate them." It is a truth that a President Obama would do well to remember.

A Splendid Exchange: How Trade Shaped the World.
By William J. Bernstein.
Atlantic Monthly Press; 467 pages; $30. Atlantic Books; £22

Economist.com BOOKS & ARTS

Russia

Doom, gloom and boom

Jul 17th 2008
From The Economist print edition

Crooks and spooks run amok in Russia

THE comforting conventional wisdom is that after Russia's chaos and humiliation in the 1990s, eight years of tough rule by Vladimir Putin has brought prosperity and stability. Russia is now on course to become free and law-abiding. These four books suggest that mild panic might be the better part of wisdom.

The most alarming (or alarmist) of the books is "The Age of Assassins". It stitches together the most lurid scandals in post-Soviet history in a narrative of infamy and camouflage, arguing that Russia is run by a gang of murderous ex-KGB men. Though Yuri Felshtinsky and Vladimir Pribylovsky present "evidence" to support their case, what they really do is raise questions of varying likelihood. Did Russia's secret services kill hundreds of people in 1999 in staged "terrorist" bombings to help Mr Putin's tough image (not as mad as it sounds)? Does the lack of evidence about Mr Putin's early childhood point to a hidden family in Georgia (not really)? What is the extent of his personal fortune (probably huge) and how exactly did he spend his years in the St Petersburg bureaucracy (murkily)?

As the authors point out, witnesses and those who investigate these mysteries tend to end up dead. That is sinister, but not proof. Idiosyncratic structure, layout and syntax also blunt the book's appeal, as does its gentle treatment of Boris Berezovsky, a prominent tycoon in the 1990s who now lives in exile in London. Any discussion of Mr Putin's rise to power is incomplete without mention of his sponsorship by, and revenge on, Russia's arch-intriguer.

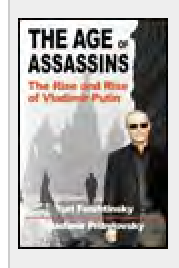
The same ground is covered more professionally by Steve LeVine in "Putin's Labyrinth". His material also includes mysterious murders, but he follows the fact-based conventions of American journalism, an art at which he excelled during a decade of reporting from the ex-Soviet area. His reconstruction of a savagely botched anti-terrorist operation at a Moscow theatre is particularly effective.

The search for balance does sometimes lead him to give undue weight to shadowy hangers-on: splitting the difference between liars and madmen does not necessarily produce the truth. But his thoughts about the casual lethality of power and wealth in Russia are all the more convincing for being cautious.

"From Soviet to Putin and Back" is an encyclopedic history of Russia's oil industry, peppered with acerbic remarks about its politics. Some of the ground was covered more readably in a 2007 book by Mr LeVine: "The Oil and the Glory" (Random House). But Michael Economides and Donna Marie D'Aleo offer an invaluable first-hand account of the way in which Soviet state planners abused their country's natural riches and Kremlin kleptocrats drove out foreign investors. Disappointingly, the book tails off before fully answering the big question: where is Russia headed now? Will the ex-KGB men now running the country's biggest hydrocarbon firms put profit first or geopolitics or simply self-enrichment?

No such doubts cloud Marshall Goldman's mind. One of America's most seasoned Kremlin-watchers, his snappily written "Petrostate" argues boldly that Russia has become an energy superpower with a strong political agenda. Readers will wince

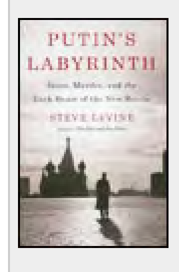
The Age of Assassins: The Rise and Rise of Vladimir Putin
By Yuri Felshtinsky and Vladimir Pribylovsky



Gibson Square Books; 320 pages; £16.99

Buy it at Amazon.co.uk

Putin's Labyrinth: Spies, Murder, and the Dark Heart of the New Russia
By Steve LeVine



Random House; 194 pages; $26

Buy it at Amazon.com

From Soviet to Putin and Back: The Dominance of Energy in Today's Russia
By Michael J Economides and Donna Marie D'Aleo

in disbelief at the way in which Russia has outmanoeuvred the European Union in tussles over pipelines. And his description of the way that Russian money has influenced politics in both Germany and America is worrying.

Trying to find a single coherent account of events in a country as diverse as Russia is risky. Mr Putin's rise to power—and his recent move out of the Kremlin to be prime minister—cannot be explained solely as part of a putsch by the old KGB (indeed Mr LeVine thinks that thesis to be "vastly exaggerated"). Economic reformers in high office may be marginalised at times but they are not there just as decoration. Russia can be a bully but also yearns for international respect. Even so, murder is murder.

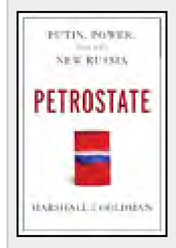
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Energy Tribune Publishing; 464 pages; $29.99

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Petrostate: Putin, Power, and the New Russia
By Marshall I. Goldman



Oxford University Press; 256 pages; $27.95

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Putin's Labyrinth: Spies, Murder, and the Dark Heart of the New Russia.
By Steve LeVine.
Random House; 194 pages; $26

From Soviet to Putin and Back: The Dominance of Energy in Today's Russia.
By Michael J Economides and Donna Marie D'Aleo.
Energy Tribune Publishing; 464 pages; $29.99

Petrostate: Putin, Power, and the New Russia.
By Marshall I. Goldman.
Oxford University Press; 256 pages; $27.95

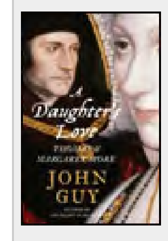
Medieval England

A Catholic father

Jul 17th 2008
From The Economist print edition

JOHN GUY does his best to make the most of the daughter in this double life of Thomas and Margaret More. The title, the jacket image, the opening section and the last chapter all emphasise her role in her father's story. But there is no avoiding the fact that we know much more about him than we do about her.

A Daughter's Love: Thomas and Margaret More
By John Guy



Fourth Estate; 378 pages; £25. To be published in America by Houghton Mifflin in March 2009

Thomas More (1478-1535), Roman Catholic saint, hairshirt-wearer and self-flagellator, chose execution rather than concede papal authority to Henry VIII over the question of his divorce of Katherine of Aragon. Nonetheless, he was a man of the world. Educated for the law, he climbed up the judicial and political ladders of Tudor England until in 1529 the king appointed him Lord Chancellor: the statesman of Hans Holbein's portrait, inscrutably grave in red velvet sleeves, furred gown and gold chain.

Early chapters of the book try valiantly to tell at least some of this story from Margaret's point of view. Unfortunately her father is forever kissing his children goodbye, leaving to hear court cases in the city or to negotiate treaties on the continent. And when he comes home, it is always such a disappointment that he shuts his study door to read, write or chat with his Dutch friend, Desiderius Erasmus.

More belonged to a circle of Dutch and English humanists who studied, translated and published classical texts and promoted the learning of Greek. He was reputed a wit, an ironist, delighting in ambiguity, both pious and scatological, at home equally with the vernacular and the rhetorical, with the Greek philosophers and the early church fathers.

His political satire "Utopia" owed much to Plato's "Republic", a work which also inspired his ideas on female education. He was perhaps the first Englishman to believe that girls were as capable of profiting from classical learning as boys. At his house in the village of Chelsea, he established a domestic academy where, alongside history, philosophy, logic and music, his three daughters, a son and various wards were taught to translate to and from Latin, Greek and English. English was important and More particularly encouraged letter-writing, an art requiring "simplicity, frankness, humour and wit".

This is where Margaret comes into her own. Always an apt scholar, she developed into possibly the most learned Englishwoman of her day. She published an English translation of Erasmus's meditations on the Lord's prayer and she wrote a treatise on the Four Last Things: death, judgment, heaven and hell.

More himself wrote on those four last things, a devotional exercise which places him squarely within the medieval Catholic tradition. Mr Guy has scrupulously researched More's family, his career and the religious controversies he engaged in. And yet his knowledge never quite rises to an imaginative understanding of the enormous power, richness and exoticism of a religious tradition that More clung to even as Luther's idea of the individual conscience was presaging the modern world.

Peter Ackroyd's biography of More, published in 1998, better caught this pre-modern world: that Bosch-like antechamber to heaven or hell, where the dead are as present as the living and where miracles and demons have a physical reality even to the educated. For More, the church was almost unimaginably central and he believed Henry's challenge to the papacy signalled its destruction. His head in the circumstances was a small price to pay.

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Medieval Hungary

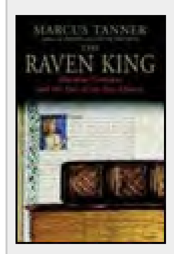
Questing lost manuscripts

Jul 17th 2008
From The Economist print edition

SOMEWHERE deep in the court of the Ottoman sultans lay the hidden library of Hungary's most famous medieval king, Matthias Corvinus. If only it could be discovered and the books prised out of Turkish hands, then all would be well and Hungarian honour and glory restored. Or so believed many a 19th-century Hungarian academic and nationalist.

"We wanted to scream we had reached our goal," wrote one, who in 1862 along with two companions had succeeded in gaining access to the court. A pile of books was brought out for them to see, including six manuscripts from the fabled library. In the end the quest was a failure; there was no hidden treasure trove. But some of the books had indeed survived for more than 300 years in Constantinople, others were found elsewhere and Marcus Tanner has written a lively account of the search.

The Raven King: Matthias Corvinus and the Fate of His Lost Library
By Marcus Tanner



Yale University Press; 352 pages; $35 and £20

Buy it at
Amazon.com
Amazon.co.uk

Matthias, known as the "Raven King", reigned from 1458 to 1490. He was born a commoner, albeit into a wealthy Transylvanian family. By the time he died, he had stemmed the relentless Ottoman advance through Europe and himself ruled over an empire that stretched from the Black Sea to Dalmatia and from Moravia to Bosnia. Within decades all of this was gone and for some 150 years Hungary was under Ottoman domination.

Hungarians came to regard Matthias's rule as a golden age, the apogee of Hungarian power. Golden age in more senses than one: Matthias assembled one of Europe's finest libraries, second in size only to the Vatican's. Given that almost all of the books were copied by hand and richly illuminated, and that most of them came from Florence and had then to be transported to Hungary, this was an amazing, and amazingly expensive, achievement. After all, when Matthias settled on Beatrice, a Neapolitan, to be his bride, it took her three months to get to him along roads infested with highwaymen and Turkish raiders.

Though many of the books commissioned by Matthias were religious, a large proportion were not. Indeed, says Mr Tanner, his taste was decidedly "alpha male". What he wanted were "war stories, lives of great rulers and books about inventions, geography, medicine, natural wonders and the stars". When Hungary fell to the Turks and the library was lost, its size in the minds of men grew exponentially. Figures of up to 50,000 books were bandied about. In fact there were probably never more than 2,500.

Today some 216 of them are known to have survived. How they did, and how they became Hungary's quest for the holy grail, is a gripping tale, helped along by Mr Tanner's penchant for intriguing asides. Beatrice loathed Hungarian fare and her sister had to send her food parcels from Italy, including cheese, olives, cumin and onions preserved in vinegar. Explicit homosexual literature was being produced in the 1420s. Translations of Greek and Latin works were often of poor quality, even if they had been prepared for princes. Although Hungarians eventually built a cult of Matthias and his library, at the time his countrymen looked down on it, regarding it as a luxury and a magnet for the irritating foreigners, especially Italians, whom it attracted to the court.

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Bottled-water industry

Waterlog

Jul 17th 2008
From The Economist print edition

Bottlemania: How Water Went on Sale and Why We Bought It
By Elizabeth Royte



Bloomsbury; 288 pages; $24.99 and £18.99

Buy it at
Amazon.com
Amazon.co.uk

"SPARKLING or still?" The waiter's question seems to offer a choice, but is in fact designed to deny it: tap water, after all, is never on the menu. According to Elizabeth Royte's "Bottlemania", in 2002 Nestlé produced a training manual aimed at waiters called "Pour on the Tips". Converting guests to pricey bottled water, it said, could boost their monthly earnings by $100 or more. Some waiters even try to humiliate people who resist. "I get great pleasure out of making each of those ladies who are trying to impress their friends repeat the word 'tap' back to me," wrote a server on "The Waiter's Revenge", an online message board.

Snobbery, convenience and worries about tap water have propelled the American bottled-water industry from sales of $4 billion in 1997 to $10.8 billion in 2006. Globally the industry is now worth about $60 billion. As well as the plain variety, there are now bottled waters laced with all sorts of extra ingredients, such as caffeine, appetite suppressants, skin enhancers and even laxatives. Bottled-water giants such as Nestlé, the Coca-Cola Company and PepsiCo reckon that the market will continue to fizz. Last year Coca-Cola spent $4.1 billion to buy Glacéau, a firm that makes vitamin-enhanced water.

For bottled-water firms large and small it has been a marketing triumph. So confident are they that one executive promised a gathering of Wall Street analysts in 2000 that tap water would eventually be used only for showers and washing dishes. For those who enjoy conspiracy theory, public water fountains are mysteriously disappearing; renovated airports, for instance, emerge without their fountains—and a proliferation of drinks-vending machines.

Villain of the piece?

It should be easy enough to pillory bottled water. It costs between 250 and 10,000 times more than tap water and in blind tastings people cannot usually separate the fancy beverage from the ordinary stuff. Then there is the environmental cost: according to one estimate, the total energy required to make and deliver each bottle of water is equivalent to filling them a quarter of the way with oil. While New Yorkers enjoy the services of water sommeliers, millions of people in developing countries lack access to any clean water at all.

But although Ms Royte displays all the usual prejudices—private enterprise bad, collective provision good—her book concludes that even in rich countries tap water sometimes contains small quantities of harmful chemicals. She also points out that in water shortages, local authorities may supply people with water reclaimed from sewage without telling them. Bottled water, therefore, "has its place": a confused message, if an honest one.

Nor do all bottled-water companies come out badly. In Fiji, half of whose inhabitants did not have access to clean water last year, the water-bottler plays an important part in the local economy: it pays well above the minimum wage, builds schools for workers' children and puts money into a trust for local infrastructure.

Yet in the past few years a backlash against bottled water has gathered pace, with some upmarket restaurants deciding to offer only tap. Gisele Bundchen, a supermodel who has campaigned to conserve fresh water in Brazil, now sports a reusable metal water bottle. What waiter could complain about that?

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By Elizabeth Royte.
Bloomsbury; 288 pages; $24.99 and £18.99

Emperor Hadrian

Strutting on the stage

Jul 17th 2008
From The Economist print edition

British Museum



That sinister crease

“Hadrian: Empire and Conflict” will be at the British Museum from July 24th until October 26th

A MASSIVE stone head of the Emperor Hadrian is the first exhibit a visitor sees in the British Museum’s exploration of “the life, love and legacy of Rome’s most enigmatic Emperor”. He is bearded with carefully coiffed curly hair, and that unmistakable deep diagonal crease in the earlobes which helps identify authentic ancient portraits of Hadrian. The head was discovered only last August in Sagalassos in south-west Turkey, and it has never been seen in public before. The decision to allow it to leave the storehouse in the local museum was taken at cabinet level in Ankara after detailed negotiations between Neil MacGregor, the British Museum’s director, and Turkey’s ambassador to London. It is a brilliant *coup de théâtre*.

This exhibition is not linked to an anniversary. The closest it gets to a relevant contemporary reference is to emphasise that one of Hadrian’s first acts on becoming Emperor in 117AD was to withdraw Rome’s army from Mesopotamia (modern Iraq). Mr MacGregor says the exhibition is one of a series exploring great rulers who shaped our world.

Hadrian was a complex, contradictory figure, ruling for 21 years. He was a dictator, sometimes regarded as a “prince of peace” by Europeans. Israelis point to him as the perpetrator of the first Holocaust. “He was not necessarily a likeable man, but his achievements were awesome,” says Thorsten Opper, the museum’s specialist in classical sculpture and the show’s curator.

The emperor was acutely conscious of his image. He had more statues of himself scattered throughout his empire than any fellow-emperor, save Augustus. A selection of the best is on show in the British Museum, lent by 31 institutions in 11 countries. Some of the fine bronze busts show him for what he was—a grizzled old soldier—but in full-sized marble statues he becomes a role-player. Dressed in a toga, he is a Greek orator; in full Roman army uniform, with his foot on the neck of a humbled barbarian, he is the protector of his people; standing naked and slim-hipped, he is a god, like Mars.

Hadrian belonged to an upwardly mobile Spanish landowning elite that had grown rich selling olive oil. In Rome he was a provincial, and fun was made of his rustic accent. He shrewdly understood the limits of

power, was ruthless in the exercise of it and cynical enough to disarm critics early in his regime by giving citizens a tax holiday. But when the second Jewish revolt began in 132AD he suppressed it with a fury that Mr Opper describes as “a slow extermination campaign”. Judea was expunged from the maps, and renamed Syria-Palestina. Quite why he ordered his great wall to be built on England’s border with Scotland is uncertain, but Mr Opper’s gut feeling is that it was to divide and rule the revolting northern tribes.

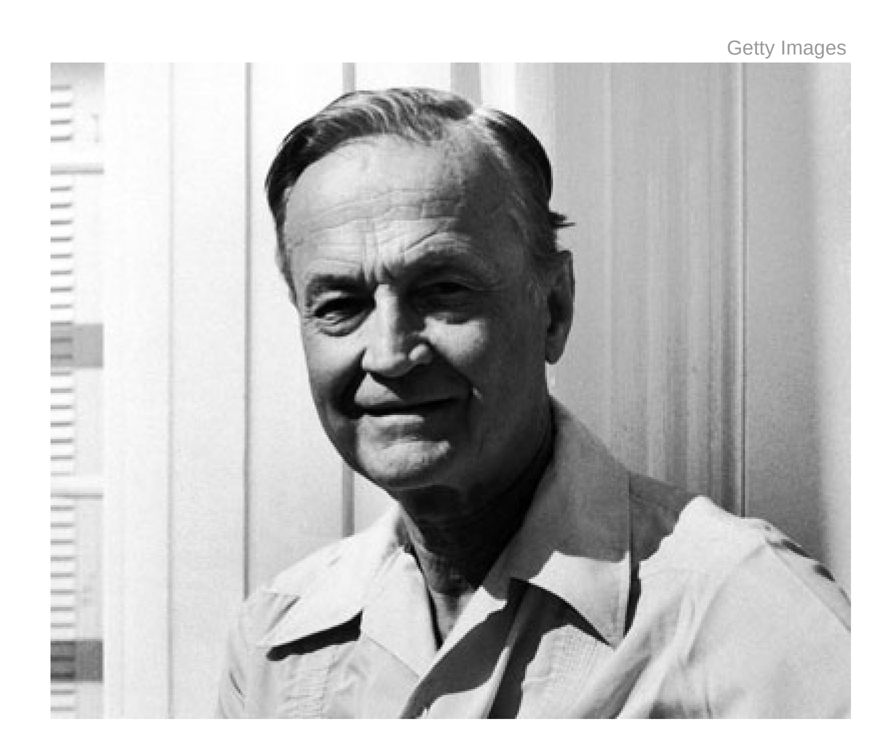
He had a fine eye for monumental architecture. He commissioned the Parthenon, and a model of it is displayed directly under Sydney Smirke’s glorious dome above the British Museum’s Reading Room (which is two feet or 0.6 metres smaller in diameter than the Roman masterpiece). His own mausoleum was by the banks of the Tiber, the Castel Sant’ Angelo.

His lover was Antinous, a handsome young Greek who appealed to the emperor’s Hellenophilia. Mr Opper’s catalogue tells us that what caused comment among his contemporaries was not that Hadrian was gay, but that he insisted that Antinous be given the status of a god after his death in the Nile in 130AD. One of many statues of Antinous—here as the Egyptian god Osiris—stands proudly outside the entrance to the exhibition. Hadrian himself died at 62, perhaps of coronary heart disease (a condition sometimes indicated by a crease in the earlobe). He had not created the role of emperor, but no one played it better.

John Templeton

Jul 17th 2008
From The Economist print edition

Getty Images



Sir John Marks Templeton, investment analyst and philanthropist, died on July 8th, aged 95

IF, ON any day over the past few decades, you had chanced to be strolling in the early morning at Lyford Cay in the Bahamas, you might have seen a wiry, determined figure power-walking in the sea. Keen as a whippet, his thin arms pumping, he headed into the prevailing swell. In his 80s, he would do an hour of this. In his 90s, he still managed 25 minutes.

Sir John Templeton spent his life going against the flow. In September 1939, when the war-spooked world was selling, he borrowed $10,000 to buy 100 shares in everything that was trading for less than a dollar a share on the New York Stock Exchange. All but four eventually turned profits. In early 2000, conversely, he sold all his dotcom and Nasdaq tech stocks just before the market crashed. His iron principle of investing was “to buy when others are despondently selling and to sell when others are greedily buying”. At the point of “maximum pessimism” he would enter, and clean up.

It took fortitude, he would say, to do the opposite of what the crowd was doing. At the very beginning, a southern boy on Wall Street against the east-coast preppies, living in a sixth-floor walk-up filled with $25-worth of furniture, it was almost foolhardy. But he learnt to look at shares distinct from the flow and emotion of the market, and his contrarian habits brought him huge success. A sum of $10,000 invested in his Class A portfolio in 1954, when he set up the Templeton Growth Fund, would have grown to $2m by 1992, when he sold his stake. That represented an annualised average return of 14.5%.

Sir John knew what he liked. Common stocks, like Dow Jones industrials, were unglamorous but usually dependable. Government bonds were steady, if you picked a country with no trade or fiscal deficits and a high savings rate. He disliked speculation, and any instrument over-geared to make money. But he was open-minded. Some moments were good for Treasuries, some for equities, some for blue-chip stocks. Late in life, he favoured market-neutral hedge funds. Diversity was important, in countries as well as instruments. A journey in 1936 round Europe and the Middle East, sleeping on open decks and chewing dry bread to save money, taught him that investment opportunities lay everywhere he looked.

But most of all Sir John went long on God. As a lifelong Presbyterian with a devout and curious mind, he reckoned that the market price of the creator of the universe was probably 1% of its actual value. The crowd might have lost interest in this underrated stock, so dully and unerringly recommended by theologians and priests down the centuries, but Sir John bought it up on the firm expectation of stellar

future earnings. Indeed the divine, he once said, if approached in a humble spirit of inquiry, might turn out to be 3,000 times more than people imagined it was.

Love and money

The Templeton Foundation, set up in 1987 and now endowed with $1.5 billion, was another sort of growth fund, monitoring God's performance in various religions and seeking proofs of divine agency in every branch of science, from chemistry to astrophysics. Scholars helped by Sir John's money investigated whether prayer and health were connected, whether water was fine-tuned to promote life, whether purpose guided the universe. (Intelligent Design was embraced, then abandoned.) The Templeton prize, a neat $1m, was awarded for individual achievement in "life's spiritual dimension". Sir John made sure it surpassed the Nobel prizes, in which spirituality was ignored. His asset might be infinite, but he meant to build it up, doing whatever he could to "help in the acceleration of divine creativity".

Sir John revered thrift and had a horror of debt. His parents had taught him that in small-town Tennessee, instilling it so well that in his white-columned house in the Bahamas, overlooking the golf course, he still cut up computer paper to make notebooks. But he made an exception for love, which needed spending. You could give away too much land and too much money, said Sir John, but never enough love, and the real return was immediate: more love. The Institute for Unlimited Love, founded with his money, was set up to study this dynamic of the spiritual marketplace. His own charity, though, was harder-edged. On earth a free capitalist system was the only way to enrich the poor. No safeguards were needed: an unethical enterprise would fail, "if not at first, then eventually."

Critics of Sir John considered him a God-obsessed right-winger. It was noted that, for all his selflessness, he fled to the Bahamas and took British citizenship in 1968 to avoid American taxes. Yet Sir John gave his money to individuals, not governments. And, with his restless, buoyant curiosity, he resisted pigeonholing. Interviewers found that they were peppered with questions and keenly listened to, and to the end the analysis was sharp: in 2003 Sir John foresaw the housing crash, and pronounced the stockmarket "broken".

From his sofa decorated with butterflies ("None of us know what's going to happen after we die, any more than that caterpillar knows"), he continued to yearn for the reconciliation of science and religion. And in the mornings he took to the sea again, striding against the flow.



Overview

Jul 17th 2008
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There was a worrying increase in **inflation** across the rich world. Consumer prices in America rose by 1.1% in June, leaving them 5% higher than a year earlier. This was the first time that America's headline inflation rate had reached 5% since 1991. In Britain consumer-price inflation rose from 3.3% in May to 3.8% in June, well above the government's target of 2%. The euro area's inflation rate was confirmed at 4%.

In **America** the value of retail sales all but stalled in June, after three months of solid increases. Total sales rose by just 0.1%. Excluding cars, for which demand has been weak, the value of sales rose by 0.8%. Industrial production rose by 0.5% in June, lifted partly by the end of a car-workers' strike.

Industrial production in the **euro area** fell by 1.9% in May, the biggest one-month decline since December 1992.

The **Bank of Japan** kept its benchmark interest rate unchanged at 0.5%, following its policy meeting on July 15th. In an update to its twice-yearly report on the economy, the bank cut its GDP growth forecasts, and raised its inflation forecasts, for 2008 and 2009.

Chinese GDP rose by an estimated 10.1% in the second quarter compared with a year earlier. Growth in 2007, when export markets were stronger, stood at 11.9%.

The number of people claiming unemployment benefits in **Britain** rose by 15,500 in June, the biggest one-month rise since 1992.



Output, prices and jobs

Jul 17th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.5 Q1	+1.0	+1.4	+1.3	+0.3 Jun	+5.0 Jun	+2.7	+4.2	5.5 Jun
Japan	+1.3 Q1	+4.0	+1.4	+1.3	+1.2 May	+1.3 May	nil	+1.4	4.0 May
China	+10.1 Q2	na	+9.8	+9.0	+16.0 Jun	+7.1 Jun	+4.4	+6.5	9.5 2007
Britain	+2.5 Q1	+1.1	+1.6	+1.2	−1.6 May	+3.8 Jun§	+2.4	+3.4	5.2 May††
Canada	+1.7 Q1	−0.3	+1.3	+2.0	−4.5 Apr	+2.2 May	+2.2	+2.0	6.2 Jun
Euro area	+2.1 Q1	+2.8	+1.7	+1.3	−1.9 May	+4.0 Jun	+1.9	+3.5	7.2 May
Austria	+2.8 Q1	+2.8	+2.3	+1.9	+3.0 Apr	+3.9 Jun	+2.0	+3.0	4.1 May
Belgium	+2.2 Q1	+1.9	+1.7	+1.5	+8.1 Apr	+5.8 Jun	+1.3	+3.9	10.0 Jun‡‡
France	+2.2 Q1	+2.6	+1.7	+1.3	−1.2 May	+3.6 Jun	+1.2	+3.2	7.4 May
Germany	+2.6 Q1	+6.3	+2.0	+1.5	+0.8 May	+3.3 Jun	+1.9	+2.9	7.8 Jun
Greece	+3.6 Q1	+4.5	+2.9	+3.0	−6.6 May	+4.9 Jun	+2.6	+4.2	7.7 Apr
Italy	+0.3 Q1	+1.9	+0.4	+0.8	−4.1 May	+3.8 Jun	+1.7	+3.4	6.5 Q1
Netherlands	+3.3 Q1	+1.8	+2.4	+1.7	+0.6 May	+2.6 Jun	+1.7	+2.4	4.0 May††
Spain	+2.7 Q1	+1.2	+1.7	+1.2	−7.3 May	+5.0 Jun	+2.4	+4.2	9.9 May
Czech Republic	+5.3 Q1	+3.6	+4.7	+5.4	+3.4 May	+6.7 Jun	+2.5	+6.5	5.0 Jun
Denmark	−0.7 Q1	−2.4	+1.3	+1.4	+7.2 May	+3.8 Jun	+1.4	+3.1	1.7 May
Hungary	+1.7 Q1	+1.3	+2.0	+3.4	+5.5 May	+6.7 Jun	+8.6	+6.3	7.7 May††
Norway	+0.9 Q1	+0.8	+2.6	+2.3	+2.8 May	+3.4 Jun	+0.4	+3.4	2.5 Apr***
Poland	+6.1 Q1	na	+5.4	+4.3	+2.3 May	+4.6 Jun	+2.6	+4.2	10.0 May‡‡
Russia	+8.5 Q1	na	+7.5	+6.8	+6.7 May	+15.1 May	+7.8	+13.9	6.4 May‡‡
Sweden	+2.2 Q1	+1.6	+2.1	+2.0	−5.0 May	+4.3 Jun	+1.9	+3.3	5.9 May‡‡
Switzerland	+3.1 Q1	+1.3	+2.0	+1.5	+4.4 Q1	+2.9 Jun	+0.6	+2.4	2.5 Jun
Turkey	+6.6 Q1	na	+4.5	+4.3	+2.4 May	+10.6 Jun	+8.6	+11.0	10.7 Q1‡‡
Australia	+3.6 Q1	+2.5	+2.9	+2.8	+2.4 Q1	+4.2 Q1	+2.4	+3.7	4.2 Jun
Hong Kong	+6.8 Q1	+7.4	+4.8	+4.9	−4.4 Q1	+5.7 May	+1.3	+5.3	3.3 May††
India	+8.8 Q1	na	+7.7	+7.1	+3.8 May	+7.8 May	+6.6	+7.1	7.2 2007
Indonesia	+6.3 Q1	na	+5.9	+5.7	+4.4 May	+11.0 Jun	+5.1	+9.9	8.5 Feb
Malaysia	+7.1 Q1	na	+5.8	+5.7	+2.6 May	+3.8 May	+1.4	+5.2	3.6 Q1
Pakistan	+7.0 2007**	na	+3.6	+4.4	+4.3 Apr	+21.5 Jun	+7.0	+15.6	5.6 2007
Singapore	+6.9 Q1	+14.6	+4.5	+5.0	−12.8 May	+7.5 May	+1.0	+4.3	2.0 Q1
South Korea	+5.8 Q1	+3.3	+4.5	+4.3	+8.3 May	+5.5 Jun	+2.5	+3.5	3.2 Jun
Taiwan	+6.1 Q1	na	+4.3	+4.4	+5.3 May	+5.0 Jun	+0.1	+3.1	3.9 May
Thailand	+6.0 Q1	+5.9	+4.8	+4.5	+10.5 May	+8.9 Jun	+1.9	+8.5	1.5 Apr
Argentina	+8.4 Q1	+2.4	+6.0	+4.0	+6.6 May	+9.3 Jun	+8.8	+9.9	8.4 Q1‡‡
Brazil	+5.8 Q1	+2.9	+4.6	+3.6	+2.4 May	+6.1 Jun	+3.7	+5.7	7.9 May‡‡
Chile	+3.0 Q1	+5.8	+3.6	+3.8	−2.4 May	+9.5 Jun	+3.2	+7.5	8.0 May††‡‡
Colombia	+4.1 Q1	−3.7	+4.8	+4.3	+9.8 Apr	+7.2 Jun	+6.0	+6.5	10.7 May‡‡
Mexico	+2.6 Q1	+2.1	+2.3	+2.5	+5.4 Apr	+5.3 Jun	+4.0	+4.8	3.2 May‡‡
Venezuela	+4.8 Q1	na	+5.2	+4.0	+19.9 Apr	+32.2 Jun	+19.4	+30.8	8.5 Q1‡‡
Egypt	+6.9 Q1	na	+6.9	+6.7	+7.5 2007**	+20.2 Jun	+8.5	+17.1	9.0 Q1‡‡
Israel	+5.2 Q1	+5.4	+3.9	+3.6	+14.1 Apr	+4.8 Jun	−0.7	+4.2	6.3 Q1
Saudi Arabia	+3.5 2007	na	+7.2	+6.7	na	+10.4 May	+4.2	+8.5	na
South Africa	+4.0 Q1	+2.1	+3.9	+4.4	+0.7 May	+11.7 May	+6.9	+9.6	23.0 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	+0.1 Q1	+7.8	−0.6	+2.0	−6.7 May	+11.4 Jun	+5.8	+10.5	4.1 May
Finland	+3.1 Q1	+2.7	+2.8	+2.3	+4.2 May	+4.4 Jun	+2.5	+3.7	6.3 May
Iceland	+1.1 Q1	−14.0	nil	+0.8	+0.4 2007	+12.7 Jun	+4.0	+12.0	1.1 Jun‡‡
Ireland	−1.5 Q1	−0.9	+1.4	+1.5	+9.2 May	+5.0 Jun	+4.9	+3.6	5.7 Jun
Latvia	+3.3 Q1	na	+2.4	+2.6	−8.5 May	+17.7 Jun	+8.8	+15.0	5.6 May
Lithuania	+6.9 Q1	−0.8	+5.5	+4.8	na	+12.5 Jun	+4.8	+10.4	4.7 Jun‡‡
Luxembourg	+2.5 Q1	+5.3	+3.1	+3.0	+6.4 May	+4.3 Jun	+2.0	+3.6	4.1 May‡‡
New Zealand	+0.9 Q1	−2.3	+1.4	+1.7	+2.4 Q1	+4.0 Q2	+2.0	+3.3	3.6 Q1
Peru	+7.3 May	na	+7.9	+6.6	+4.6 May	+5.7 Jun	+1.6	+5.1	7.9 May††
Philippines	+5.1 Q1	+3.0	+4.8	+5.7	+5.2 Apr	+11.4 Jun	+2.3	+8.3	8.0 April‡‡
Portugal	+0.9 Q1	−1.0	+1.5	+1.4	−6.4 May	+3.4 Jun	+2.4	+2.4	7.6 Q1‡‡
Slovakia	+8.7 Q1	na	+7.5	+5.2	+4.0 May	+4.6 Jun	+2.5	+4.2	7.4 May††
Slovenia	+5.4 Q1	na	+4.5	+4.0	−0.8 May	+7.0 Jun	+3.6	+5.5	6.5 May‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 4.6% in June. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Jul 17th 2008
From The Economist print edition

The Economist commodity-price index
2000=100

	Jul 8th	Jul 15th*	% change on one month	% change on one year
Dollar index				
All items	265.6	265.1	-1.0	+30.1
Food	270.3	268.1	-3.6	+56.8
Industrials				
All	259.4	261.2	+2.7	+6.0
Nfa†	203.7	204.8	-2.3	+25.6
Metals	289.9	292.0	+4.7	+0.1
Sterling index				
All items	204.2	200.5	-3.6	+32.6
Euro index				
All items	156.6	153.5	-3.9	+12.3
Gold				
$ per oz	914.90	986.00	+11.9	+48.0
West Texas Intermediate				
$ per barrel	135.81	138.57	+3.6	+87.1

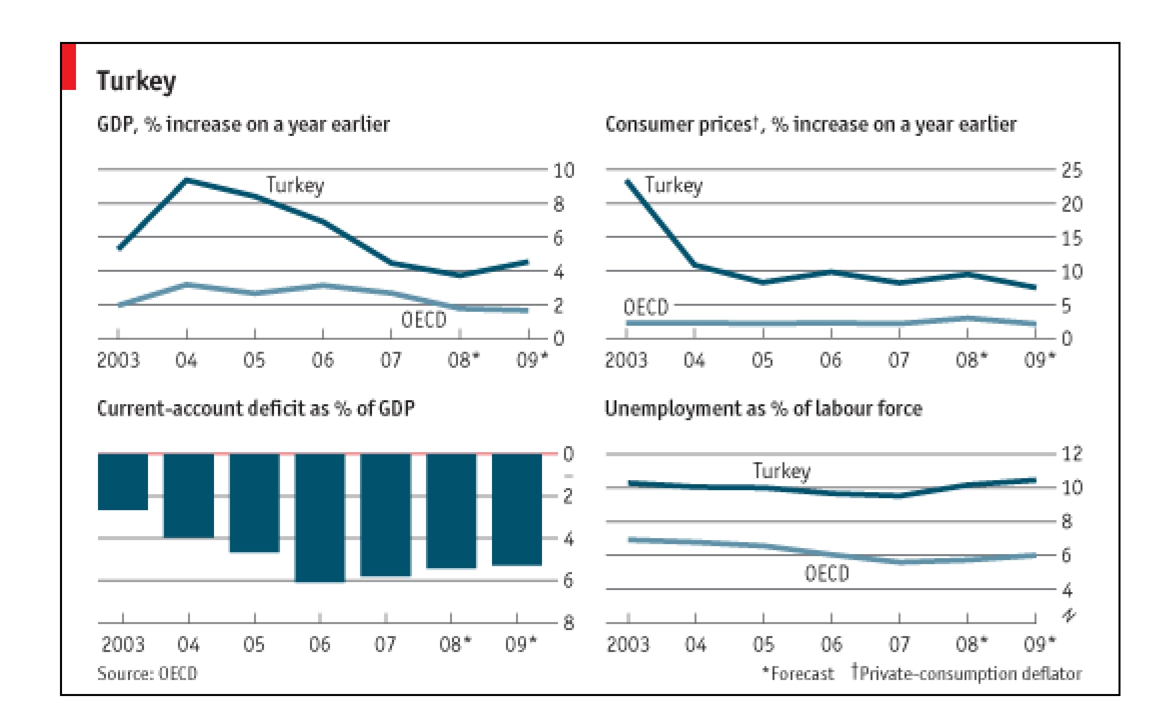
*Provisional †Non-food agriculturals.



MARKETS & DATA
WEEKLY INDICATORS

Turkey

Jul 17th 2008
From The Economist print edition





Trade, exchange rates, budget balances and interest rates

Jul 17th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Jul 16th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−835.2 May	−710.7 Q1	−4.9	–	–	−2.4	2.31	3.93
Japan	+101.0 May	+215.1 May	+4.1	105	122	−2.7	0.75	1.57
China	+248.7 Jun	+371.8 2007	+9.3	6.81	7.56	0.4	4.42	4.66
Britain	−185.4 May	−102.4 Q1	−4.1	0.50	0.49	−3.6	5.75	4.87
Canada	+45.7 May	+14.5 Q1	+0.8	1.00	1.04	0.2	2.21	3.75
Euro area	+17.3 Apr	−2.5 Apr	−0.3	0.63	0.72	−0.9	4.96	4.38
Austria	+0.8 Apr	+14.8 Q1	+3.0	0.63	0.72	−0.4	4.96	4.59
Belgium	+12.3 Mar	−1.1 Mar	+1.6	0.63	0.72	−0.5	5.03	4.75
France	−66.3 May	−41.6 May	−1.6	0.63	0.72	−2.9	4.96	4.60
Germany	+279.0 May	+269.1 May	+6.3	0.63	0.72	1.2	4.96	4.39
Greece	−61.8 Apr	−46.4 Apr	−13.9	0.63	0.72	−2.6	4.96	4.98
Italy	−12.7 Apr	−57.8 Apr	−2.6	0.63	0.72	−2.6	4.96	5.01
Netherlands	+60.4 May	+50.7 Q1	+6.0	0.63	0.72	0.7	4.96	4.60
Spain	−149.4 Apr	−160.6 Apr	−9.5	0.63	0.72	−1.1	4.96	4.71
Czech Republic	+5.0 May	−3.6 May	−2.6	14.6	20.5	−2.2	4.11	4.75
Denmark	+4.8 May	+3.5 May	+0.9	4.71	5.39	3.8	5.70	4.67
Hungary	+0.5 May	−7.2 Q1	−5.9	146	178	−4.2	8.54	8.60
Norway	+73.9 Jun	+68.8 Q1	+17.1	5.10	5.73	17.7	6.46	4.88
Poland	−17.4 Apr	−20.3 Apr	−4.0	2.04	2.72	−2.0	6.60	6.37
Russia	+164.1 May	+109.9 Q2	+6.0	23.3	25.4	3.6	11.00	6.67
Sweden	+18.8 May	+40.4 Q1	+8.1	6.02	6.64	2.4	4.23	4.22
Switzerland	+14.6 May	+91.4 Q1	+15.1	1.02	1.20	0.9	2.80	3.08
Turkey	−69.7 May	−43.0 May	−6.4	1.22	1.28	−2.7	19.15	7.41‡
Australia	−21.3 May	−61.4 Q1	−5.5	1.03	1.14	1.4	7.77	6.32
Hong Kong	−26.0 May	+26.6 Q1	+9.3	7.80	7.82	3.0	2.22	3.38
India	−85.0 May	−17.5 Q1	−3.0	43.1	40.4	−3.4	9.00	9.94
Indonesia	+38.0 May	+10.9 Q1	+2.3	9,141	9,100	−1.8	9.62	7.66‡
Malaysia	+35.9 May	+30.6 Q1	+14.0	3.23	3.45	−3.1	3.70	4.26‡
Pakistan	−20.7 Jun	−10.5 Q1	−8.0	71.2	60.4	−6.2	13.94	12.13‡
Singapore	+28.5 Jun	+35.8 Q1	+23.3	1.35	1.52	1.0	1.14	3.15
South Korea	+1.5 Jun	+1.7 May	−0.8	1,009	916	1.1	5.52	5.98
Taiwan	+13.8 Jun	+32.2 Q1	+5.3	30.4	32.8	−1.9	2.75	2.56
Thailand	+7.9 May	+13.2 May	−0.4	33.5	33.5	−3.0	3.75	5.36
Argentina	+11.4 May	+7.9 Q1	+2.9	3.03	3.10	1.7	16.25	na
Brazil	+30.8 Jun	−15.2 May	−1.1	1.60	1.86	−1.6	12.17	6.16‡
Chile	+18.9 Jun	+4.3 Q1	+0.5	491	516	8.9	6.84	4.42‡
Colombia	+0.4 Apr	−5.0 Q1	−3.7	1,764	1,927	−1.6	9.65	6.08‡
Mexico	−8.9 May	−4.8 Q1	−0.8	10.3	10.7	−0.1	8.02	9.22
Venezuela	+30.1 Q1	+26.7 Q1	+10.6	3.37	4.23§	2.4	17.26	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.31	5.68	−7.1	10.01	5.49‡
Israel	−13.4 Jun	+4.4 Q1	+0.2	3.35	4.26	−1.3	3.71	5.64
Saudi Arabia	+150.8 2007	+95.0 2007	+34.6	3.75	3.75	21.0	3.70	na
South Africa	−11.0 May	−22.3 Q1	−8.0	7.61	6.96	0.4	12.45	10.26
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.3 Apr	−3.3 May	−10.5	9.89	11.3	−0.4	6.38	na
Finland	+12.3 Apr	+9.6 May	+4.7	0.63	0.72	4.5	4.89	4.59
Iceland	−1.3 Jun	−3.5 Q1	−14.6	78.0	59.5	2.0	15.97	na
Ireland	+37.2 Apr	−14.7 Q1	−3.2	0.63	0.72	−1.7	4.96	4.76
Latvia	−6.7 May	−6.0 nil	−14.0	0.44	0.50	nil	5.81	na
Lithuania	−7.8 May	−6.0 May	−11.3	2.18	2.50	−0.7	5.81	na
Luxembourg	−6.5 Apr	+4.9 Q1	na	0.63	0.72	0.6	4.96	na
New Zealand	−3.6 May	−10.4 Q1	−7.1	1.30	1.26	1.2	7.85	6.00
Peru	+7.8 May	+0.8 Q1	−1.0	2.82	3.16	2.4	6.00	na
Philippines	−7.6 Apr	+5.6 Mar	+2.6	45.5	45.3	−0.9	5.94	na
Portugal	−30.3 Apr	−26.0 Apr	−8.5	0.63	0.72	−2.4	4.96	4.86
Slovakia	−0.9 May	−4.3 Mar	−4.2	19.2	24.0	−2.1	3.58	5.03
Slovenia	−3.6 Apr	−2.8 Apr	−5.8	0.63	0.72	0.1	na	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

Markets

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From The Economist print edition

Markets

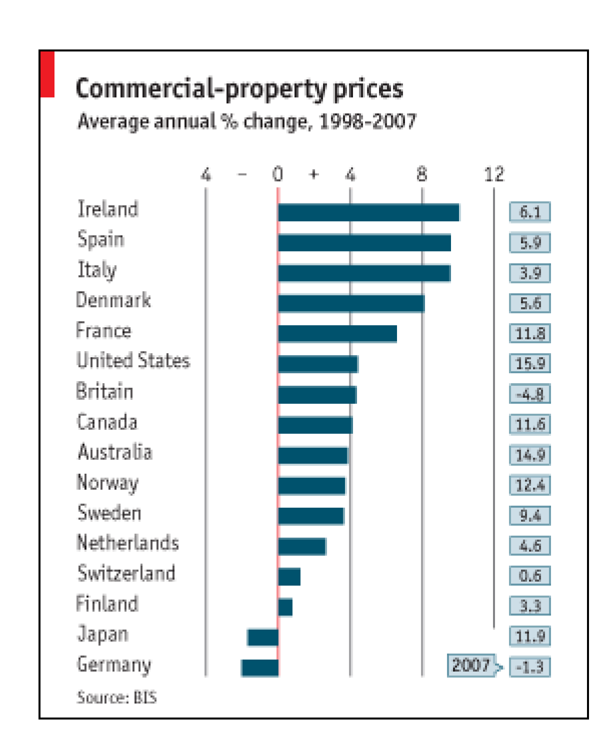
	Index	% change on	Dec 31st 2007	
	Jul 16th	one week	in local currency	in $ terms
United States (DJIA)	11,239.3	+0.8	−15.3	−15.3
United States (S&P 500)	1,245.4	+0.1	−15.2	−15.2
United States (NAScomp)	2,284.9	+2.2	−13.9	−13.9
Japan (Nikkei 225)	12,760.8	−2.2	−16.6	−11.1
Japan (Topix)	1,249.3	−2.8	−15.3	−9.8
China (SSEA)	2,838.1	−7.4	−48.6	−44.9
China (SSEB, $ terms)	208.9	−5.5	−46.8	−42.9
Britain (FTSE 100)	5,150.6	−6.9	−20.2	−20.0
Canada (S&P TSX)	13,503.8	−0.8	−2.4	−4.1
Euro area (FTSE Euro 100)	988.8	−5.1	−28.1	−22.2
Euro area (DJ STOXX 50)	3,174.8	−5.0	−27.8	−21.9
Austria (ATX)	3,436.4	−9.4	−23.9	−17.6
Belgium (Bel 20)	2,905.4	−5.9	−29.6	−23.8
France (CAC 40)	4,112.5	−5.2	−26.7	−20.7
Germany (DAX)*	6,155.4	−3.6	−23.7	−17.4
Greece (Athex Comp)	3,155.1	−7.3	−39.1	−34.1
Italy (S&P/MIB)	27,194.0	−5.5	−29.5	−23.7
Netherlands (AEX)	384.0	−6.5	−25.6	−19.4
Spain (Madrid SE)	1,214.0	−6.0	−26.1	−20.0
Czech Republic (PX)	1,398.6	−3.9	−22.9	−4.3
Denmark (OMXCB)	359.2	−5.6	−20.0	−13.4
Hungary (BUX)	20,350.0	−2.3	−22.4	−8.4
Norway (OSEAX)	470.0	−8.2	−17.5	−12.3
Poland (WIG)	37,507.6	−6.2	−32.6	−18.6
Russia (RTS, $ terms)	2,175.5	−0.2	−10.0	−5.0
Sweden (Aff.Gen)	255.7	−3.5	−24.9	−19.3
Switzerland (SMI)	6,583.5	−4.9	−22.4	−13.6
Turkey (ISE)	36,374.4	+2.2	−34.5	−36.8
Australia (All Ord.)	4,947.5	−2.8	−22.9	−14.3
Hong Kong (Hang Seng)	21,223.5	−2.7	−23.7	−23.7
India (BSE)	12,575.8	−9.9	−38.0	−43.3
Indonesia (JSX)	2,218.1	−3.0	−19.2	−17.0
Malaysia (KLSE)	1,119.4	−1.8	−22.5	−20.6
Pakistan (KSE)	10,491.9	−11.1	−25.5	−35.5
Singapore (STI)	2,835.3	−2.8	−18.2	−12.8
South Korea (KOSPI)	1,507.4	−0.8	−20.5	−26.3
Taiwan (TWI)	6,710.6	−4.8	−21.1	−15.7
Thailand (SET)	670.0	−7.1	−21.9	−21.5
Argentina (MERV)	1,877.4	−3.6	−12.7	−9.2
Brazil (BVSP)	62,056.0	+4.2	−2.9	+8.3
Chile (IGPA)	13,332.2	−2.7	−5.3	−4.0
Colombia (IGBC)	8,719.4	−3.9	−18.5	−6.7
Mexico (IPC)	27,968.8	−0.5	−5.3	+0.8
Venezuela (IBC)	39,066.6	+0.4	+3.1	−33.9
Egypt (Case 30)	9,439.4	−0.7	−9.8	−6.4
Israel (TA-100)	891.3	−4.3	−22.8	−11.4
Saudi Arabia (Tadawul)	8,861.2	−1.5	−19.7	−19.6
South Africa (JSE AS)	26,877.0	−4.0	−7.2	−16.6
Europe (FTSEurofirst 300)	1,116.0	−5.5	−25.9	−19.8
World, dev'd (MSCI)	1,337.5	−1.8	−15.8	−15.8
Emerging markets (MSCI)	1,015.9	−2.0	−18.4	−18.4
World, all (MSCI)	338.2	−1.8	−16.1	−16.1
World bonds (Citigroup)	777.9	+1.0	+6.5	+6.5
EMBI+ (JPMorgan)	431.7	nil	−0.4	−0.4
Hedge funds (HFRX)	1,291.7	−0.4	−2.9	−2.9
Volatility, US (VIX)	25.1	25.2	22.5	(levels)
CDSs, Eur (iTRAXX)†	102.3	+2.3	+102.1	+118.7
CDSs, N Am (CDX)†	146.1	+1.7	+66.8	+66.8
Carbon trading (EU ETS) €	24.9	−4.3	+12.1	+21.4

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.



Commercial-property prices

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From The Economist print edition



Even as America's housing boom turned to bust last year, commercial-property prices were still accelerating, according to figures from the Bank for International Settlements (BIS). Commercial-property inflation rose by 15.9% in 2007, a slightly faster increase than in 2006. In Britain, however, commercial-property prices dropped by 4.8% last year, after a big run-up in 2006. Price increases also slowed in Ireland, Italy, Spain and Denmark. A sizeable chunk of bank assets in America are linked to commercial-property prices, according to the BIS. It cites reports of a gradual weakening in lending standards in recent years—a worrying echo of the subprime crisis in residential mortgages.